THE DAWES PLAN AND THE NEW ECONOMICS

BY

GEORGE P. AULD

Former Accountant General of the Reparation Commission

WITH FOREWORD BY

RUFUS C. DAWES

LONDON

GEORGE ALLEN & UNWIN LTD.

MUSEUM STREET

PRINTED IN THE UNITED STATES OF AMERICA

To the Memory of

MY FATHER

FOREWORD

THE author has chosen an opportune moment to set forth in this book the basis of the Dawes Plan, its actual accomplishments and the outlook for its continued successful operation. The subject is of great importance to the business of the world because of its vital connection with the movement of commerce and the flow of credit, and it is of serious interest politically to all the governments of Europe and to the United States. At present, this importance and this interest are greater than at any time since the first few months of the operation of the plan.

The announced purposes for which the Committee of Experts was convened have already been fulfilled. Those purposes were the stabilizing of Germany's currency and the balancing of her budget. By the coöperation of the governments signatory to the plan, German statesmen and financiers have been enabled to accomplish these results. In addition, toward the fulfillment of the broader purposes of the plan, great progress has been made. For three years the subject of reparations has been removed from the sphere of acrimonious debate in the parliaments of the world, confidence has to

a considerable extent been restored, and long steps have been taken toward the restoration of normal relationships in the movement of credit and the goods of commerce.

The third year of the reparation settlements under the Dawes Plan has been completed and in less than another twelve months the period of maximum payments will begin. There have been numerous prophecies of failure and the date of the predicted failure is now drawing near. Public and private discussion of the subject is noticeably mounting, month by month. What are the probabilities of the continued operation of the plan, what would be the consequences of its collapse, and what agreements or agencies could then take its place, are questions on which all bankers and business men and all the statesmen of the world need and desire every means of forming a sound judgment.

The author of this book is admirably equipped to supply and interpret the information necessary to reach such a judgment. Mr. Auld was graduated with honours from the University of Vermont. He served during the war in the United States Navy as a regular officer of the Supply Corps and Chief Accounting Officer of the Navy and received decoration for distinguished service. He was attached to the American Commission to Negotiate Peace in 1919 as an assistant financial adviser. From 1920 to 1924 he was Accountant General of the Reparation Commission and in September and October of the latter year he assisted Owen D. Young in installing

the Dawes Plan. He is now associated with a well-known firm of certified public accountants in New York City. He has been an active participant in the world-wide discussion of reparations, contributing to newspapers and magazines both in England and the United States. His article in *Foreign Affairs* (New York) under the pen-name of "Alpha," which appeared prior to the organization of the Committee of Experts, attracted wide attention and favourable comment. The reputation, thus gained, for independence of thought and clearness of expression has been well sustained in articles that have appeared since that time.

This book, the reader will discover, is not only timely but informing, clarifying, and convincing. Just as "Alpha" in 1923 gave a new direction to the discussion of reparations, so, in this book, with the same courage and independence, Mr. Auld presents a new, vigorous, and hopeful discussion as to the effect of the revived movement of international credit. The position taken in both cases is essentially the same, but it is now fortified by the course of events.

RUFUS C. DAWES.

Evanston, Illinois,
September 8, 1927.

PREFACE

SINCE a few months after the signing of the Treaty of Versailles an influential school of thought has been committed to a body of doctrine built around the proposition that the mechanics of exchange will seriously hinder or prevent the "transfer" of German reparation payments into foreign currencies suitable for use by Germany's creditors. The various ideas of this school have been best set out in the writings of certain English economists, notably in those of J. M. Keynes, who outlined these doctrines in two widely circulated books, *The Economic Consequences of the Peace* (1919) and *A Revision of the Treaty* (1922).

The conclusion to which these ideas pointed, and still point, is cancellation of the reparation debt—not in due time when the continued payment of reparations shall have accomplished its purpose, but prematurely, in the near future, as an unavoidable consequence of the operation of economic law. Further than that, on the principle that something which is bound to come in the near future would better be brought to pass right away, immediate cancellation has consistently been the avowed aim of many of this school.

Acceptance of the proposition that the transfer of payments cannot continue has led to two other conclusions, both of which follow logically from the premise. These are that it is useless to ask whether justice and the highest expediency do not recommend reparations as a means of relieving the disproportionate burdens laid on France by the war; and that it is superfluous to try to find out what those burdens really amount to in comparison with those of Germany. These considerations being irrelevant, that which remains as a basis for international policy is simply to persuade the French that their burdens are inevitable and that the ills attendant on carrying them without relief should be borne with equanimity.

Outside of France these views gained a powerful hold on economic thought during the bitter controversy which in 1923 culminated in the occupation of the Ruhr; and in England they determined national policy on the reparation question. That policy may be said to have represented the attempt of economic science to solve a problem compounded in reality not only of economic factors but also of elements deeply concerned with social philosophy, the political arts, and the practices of international conciliation. The science of economics, working through the channels of British foreign policy, conspicuously failed to cope with it.

It failed not solely because the problem was broader than science, but also because in the field

of economics itself only a single aspect, generally speaking, received attention, and that aspect was seen indistinctly. For the supposed new law regarding foreign exchange was only a half-formed hypothesis. It succeeded among economists almost too well. It was enthusiastically acclaimed and passed into the portals of the science before it had been tested. And this began to have its embarrassments. For, where the hypothesis conflicted with the teachings of economic history, the latter had to be ignored, and where it failed to fit in with economic facts currently appearing in related aspects of the problem, other hypotheses had to be hastily constructed for the purpose of explaining those facts away.

With the coming of the Dawes Plan in 1924 these doctrines suffered a temporary eclipse. A majority of the members of the Dawes Committee were business men of large outlook and broad experience in affairs, and the plan that emerged was founded on the proposition that reparations ought to be and could be paid. But many of the other school remained unconvinced that the plan would work, and to-day they are confidently predicting its collapse in the year commencing September 1, 1928.

The doctrine of the mechanical impossibility of debt payment and its related doctrines, when dissected, are seen to be based on misconceptions regarding the nature of world economic relations and the effect of the war upon those rela-

tions. By reason of the new position of America as the great producer of surplus capital, none of the difficulties heretofore predicted as being close at hand have yet appeared. The loans being made to Germany by American investors are performing a dual function. In their broad economic significance they are rebuilding Germany. At the same time, in the mechanical aspect of exchange, they are providing, in a wholly natural way, the dollar exchange against which the reparation payments are being transferred out of Germany. We are warned, however, that this cannot continue—that it is abnormal and dangerous for all concerned. This warning is the latest and at present the most crucial form which the doctrines of disaster have taken. Like its predecessors, it will not stand the test of careful examination.

All these ideas, however, have elements of plausibility, they command a certain measure of belief in high places, and, in consequence, they are potentially destructive. For the Dawes Plan and the system of investment of American capital abroad, which now meshes in with it, operate as integral parts of the world credit structure. That structure rests on public confidence and that confidence these doctrines directly attack.

The breakdown of the Dawes Plan, which the dissemination of this philosophy promotes, would be a grave misfortune to the Allies, to Germany and, in a less but still substantial degree, to the

United States. France needs reparations, and the French are unable to see any good reason why, in a world at peace, with good faith and judgment in control at strategic points, France should not be paid. A crisis in Franco-German relations such as would be precipitated by a suspension of reparation payments could scarcely fail to have seriously adverse effects on the recovery of Europe, on our own export trade, and on the fortunes of our investors.

As these words are written, Mr. Keynes provides a clear-cut text for much that appears in this book. In *The New Republic* of August 3, 1927, he says: "Dates which were distant creep nearer. The Dawes Plan will break down according to schedule. The question is—what will be the price of its modification? How considerable a crisis will have to be provoked in Germany's affairs before the facts are admitted? . . . It is probable that the authors of the Dawes Plan did not expect their scheme to work."

That a renewed agitation over reparations was due has been clear for some time. The words just quoted indicate that it is definitely under way. Like previous movements of the kind, it will gather up within it not only those who believe the transfer of reparations to be impracticable but also those who hold various special views in opposition to the purposes of the plan, including not a few who feel that the required payments throw an unfair burden on Germany. A new class which the move-

ment now beginning seems also to be attracting consists of those who imagine that the transfer of reparations will in some way interfere with the transfer of interest and of capital repayments on Germany's foreign commercial debt.

Placed in its proper background, this agitation will prove harmless. To provide such a background for American readers has been one of the chief aims in the writing of this book. An understanding of the nature of capital and its movements in the world system gives to the dark prognostications which are being uttered on the subject of transfers and loans the appearance of mere superstitions. And a study of the effect of the payments under the plan on the burdens of the principal nations concerned indicates that the fairness of the settlement cannot reasonably be impeached.

The American attitude will be the greatest single factor in the chapter of the reparation controversy that is now opening. Our investors, manufacturers, and farmers have important interests at stake, and the weight of their combined influence on European affairs is prodigious. The guarantee that the Dawes Plan will stand the coming test lies in the intelligence of the American public, in the capacity of the layman—the true practitioner of economics and the real moulder of economic forces —to form his own judgments.

Two Americans, Charles G. Dawes and Owen D. Young, played a great part in the making of the

plan. The American people have had confidence in the fairness and practicality of the settlement that was so largely the work of those men. If the weight of opinion in this country remains in the scales on the side of sanity and stability, nothing but the unlikely contingency of a campaign of out-and-out repudiation can seriously threaten the plan and the movement toward world recovery that it promotes.

G. P. A.

New York, August, 1927.

CONTENTS

THE DAWES PLAN AND THE NEW ECONOMICS

CHAPTER I

THE WORLD ECONOMIC MACHINE

TEN years after the outbreak of the Great War the adoption of the Dawes Plan for the settlement of the reparation question opened a new era in world economic relationships. It provided the basis of a new orientation of economic forces in which America, instead of Europe, was to be supreme.

The machinery of world trade had been stalled for a decade. During four years of that period, the productive powers of mankind had been devoted partly to the satisfaction of the barest demands of subsistence, and for the remainder, to the demolition of economic values, chiefly European. Broadly speaking, no part of the accruing income of the civilized world had been set aside according to the usual custom, in the form of new productive assets. That part of income which ordinarily would have been saved, and much more than that, had been consumed, not merely unprofitably but for destruc-

tive ends. Accumulated capital in untold billions had been blown up or dissipated.

During four years of war and the six years which followed, the economic mechanism by means of which the peoples of the world exchange the fruits of their labours and achieve the material bases of a tolerable existence had been rusting to pieces. In the autumn of 1924, it was started up again, but its motive power, which formerly had come from Europe, now came from the United States. The Dawes Plan was the means of releasing these new forces; and it remains the guarantee that they will continue.

This world mechanism which was started up afresh six years after the Armistice was a relatively new thing. It was within the memory of men still living that the world had become so organized that the fortunes of a producer were closely affected by the circumstances of a consumer three, five, or ten thousand miles away. In the fifty years of comparative peace which had elapsed between the end of our Civil War and the beginning of the World War, man had erected a highly developed economic structure on the foundations supplied by the industrial revolution of the preceding generation. But this new structure, while rooted in the discoveries and inventions of the early years of the Nineteenth Century, was, in size and complexity and in the intensity of the currents pulsating through it, unlike anything which had gone before.

During the period of its erection, great elemental forces had been harnessed to the service of man on a scale never before dreamed of. As a result of the widespread application of steam and electricity to industry, production had been immensely increased and capacity to produce had been expanded many fold. Responding to the intensification of production, the movement of every economic force had been accelerated; and reflecting the radical alteration in productive methods, the structure of every economic organ had been transformed and greatly ramified. The machine age had arrived. Millions of people had been pushed into the cities and were creating for others and demanding for themselves countless new and elaborate objects required for the satisfaction of life in an artificial environment. Birmingham, Sheffield, Pittsburgh, Detroit, Essen, Lyons, Milan, and a hundred other new or greatly expanded centres of human activity were pouring a gigantic output of manufactured goods into the warehouses of trade.

In little more than a half century, economic relationships, once simple and direct, had become immensely complicated. Producers and consumers were widely separated and, joining or otherwise serving them, there had sprung up a wide variety of new occupational groups. Commerce had been revolutionized by the transcontinental railroad, the ocean-going cargo steamer, and the submarine telegraph. The business of transportation, its plant,

equipment, and organization, had assumed enormous proportions.

The continents had been overlaid with a web of 500,000 miles of steel roadways upon which millions of freight cars moved in a ceaseless stream. At the crossroads of new or revitalized internal trade routes stood great distributing centres, which within a few years had increased in population many times over. Within fifty years or less, the Alps had been pierced by three great tunnels, and at three economically strategic points—Suez, Sault Sainte Marie, and Panama—the seas had been joined together by canals. Seaports had been developed as never before. Thirty-eight billion dollars' worth of goods moved annually in international trade, 80 per cent. of it sea-borne. Europe had become the centre of a network of steamship routes reaching to all the ports of the world. Forty-two million gross tons of steel steamers, nearly half of them British, 12 per cent. German, and about 4 per cent. each French and American, plied the oceans, where a few decades before only a negligible fraction of such a fleet had been in existence. Distribution, in short, had become a network of enterprises of prodigious size and complexity.

Within the half century, consumers' demand, the complement of production, had risen to a substantially higher plane, though not commensurately with production. Consumption was kept down by thrift and by the inequality of the rewards of hu-

man effort. Many earned less than they needed; some earned much more than they could spend.

Representing the surplus of production over consumption—the margin between the earnings of the population and their expenditures—large accumulations of capital had come into being. This excess production had gone into new plants, to provide productive capacity to meet the constantly expanding material demands of society. Into a great credit pool annually flowed billions of savings, to be distributed in a ceaseless process of fertilization and refertilization, for the creation of facilities for the exploitation and transformation of materials.

Charged with the responsibility of this distribution, the business of finance, working through the delicate machinery of currency, credit, and exchange, mobilized the funds of investors and stood sponsor for the organization of great corporate enterprises. In 1914, the English joint stock banks (excluding the Bank of England) had deposits aggregating four and one half billion dollars[1], or more than twice what they had been fifty years before. The influence of such European institutions and that of the rapidly growing banking houses of the United States was felt in every department of human life.

The distribution of surplus production as free capital seeking investment had taken on an inter-

[1]The American system of numeration is used in this book, viz.: a thousand million = a billion (equivalent to the European milliard); and a million million = a trillion (equivalent to the European billion).

national aspect, which was responsible in large part for the primacy of Europe in the world system. All civilized nations produced economic surpluses of production over consumption, large or small; they were divided into two classes as to the disposition made of them. The demands of the newer countries for the means of internal development exceeded the amount of their own savings, all of which were consequently invested at home; on the other hand, Europe's demand for new capital was constantly less than its accruing surplus, the opportunities for the exploitation of new resources at home being limited.

Of Europe's economic surplus, therefore, a part was available for export, and the less developed continents took it. It was that movement of the exportable surplus of highly productive communities to the less fertile or less advanced areas which furnished the latter with the necessary material bases of productivity. It is that movement, constituting a secondary aspect of trade, which is the significant factor in world development, or, as it is to-day, world reconstruction.

In its primary manifestation, trade is essentially no more than barter, though each of the opposite movements comprising it produces intermediate instruments in the form of bank credits, which are exchanged against each other in the actual mechanics of settlement. In substance, however, it is only barter; it is the movement of consumption

commodities against each other, the movement of wheat, cotton, and automobiles against coffee, dress goods, and rubber, permitting division of labour and giving diversity to the diet, dress, and other paraphernalia of existence. In this aspect, trade between civilized countries can never long be interrupted in time of peace; nor was it after the war.

Barring elemental catastrophe or social upheaval, there is no civilized country, however prostrate from other causes, which cannot produce enough to support life in some fashion. Drought, flood, plague, earthquake, or anarchy may effectively suppress all productivity, but nothing else can do so. In their absence, the requirements of the country for subsistence will be met through direct consumption of a part of its product and through the exchange of the remainder, with other nations, for consumption goods of equal value. It is clear that some substantial proportion of the normal volume of trade of this character is always automatically assured by the fact that the exports pay for the imports.

But in the secondary and more complex aspect of trade, without which no new area could be developed or no wasted area be reclaimed, that is not the case. The movement of surplus product to countries requiring it has no such automatic basis, for the surplus does not move against incoming commodities. It cannot, for it is moving to countries having

no surplus production to offer in payment. It moves as loaned capital against long-term credit. To be reclaimed, then, a country must possess the fundamentals of credit.

In the barter aspect of trade, the business of finance serves in a more or less mechanical capacity to facilitate the exchange of consumption goods against each other. It provides short-time foreign credits which, being discharged from the proceeds of the sale of the goods, are practically self-liquidating. In this field of trade, finance is a mere handservant of the manufacturer and the merchant. It is these latter who are supreme.

But, in the more complex aspect of trade, the surplus of industry moves outward through the inspiration and direct instrumentality of finance. Finance finds investors who are willing to take foreign promises to pay. It mobilizes their funds and places them to the credit of the foreign borrower; and with these funds the latter is able to purchase the manufacturer's surplus products. In effect, the exportable surplus of industry is loaned abroad for the account of the investor.

In this field of trade, finance has taken its place as the equal or more than equal partner of industry in creating the modern international system in its most significant sense. The importance of finance in this connection lies not only in the power which it wields, but also in the intelligence required of it, for it is only by a careful selection of risks that the

investor, upon whom the whole system depends, may be protected. The significance of the process lies in the fact that only in the movement of the surplus can there be prosperity, as modern conditions define it, either for the nation which produces the surplus, not needing it, or for the nation which, needing it, does not produce it.

It was the European banker—chiefly of England but also of Germany and France—backed by the European manufacturer, merchant, and investor, who built this system, and over a considerable period of years put the surplus of the Old World to work productively in America and the other continents.

A part of Europe's surplus was in services—financial services, transportation, insurance, services to our tourists and to the European families of our immigrants—all of these things being repositories of economic effort and value in the same way as are materials. The financial services rendered by Europe embraced the interest charges for the use of previously loaned surplus. Europe took its payment for financial services in the same way as for the rest of its annually loaned surplus, namely, by making new loans. It was the only means there was for taking payment; debtor countries had only credit to offer in exchange for the surplus product of creditor countries. The result was that the interest on Europe's loans was, in the aggregate, capitalized—it was added to the capital. Interest instalments

and maturing debts were paid in cash by the individual debtors in detail and were received in cash by the individual creditors in detail, but in the aggregate they were refunded by new loans made by new individual creditors to new individual debtors.

U in the United States paid interest and debt instalments to G in Great Britain with sterling which S in the United States borrowed from B in Great Britain. S needed new capital and that capital was obtainable only in England. But he did not need all of it in sterling, to be expended for British goods; some of it he required in dollars for expenditure in this country; and through the medium of the banks he obtained U's dollars in exchange for part of his own sterling. It is clear from this that the adding of interest to capital and the refunding of maturing loans had no significance to individuals. It was a national operation—an aggregate result, of which individual debtors and creditors had no specific knowledge and which left them unaffected in their individual relationships.

As a result of this process, America, Asia, and Africa, when the war came, were indebted to England, Germany, and France, in an amount equivalent to about 50 billion dollars of to-day (i.e., 33 billion pre-war dollars), three fifths of it owed to England.[1] This constituted, so far as anyone could

[1]Estimates by Harvey E. Fisk, *The Inter Ally Debts*, Bankers Trust Company, New York, 1924.

foresee, a permanent or semi-permanent and gradually increasing capital indebtedness. America, producing no exportable surplus, was what might be termed a natural debtor continent. Europe, on the other hand, was a natural creditor continent. The creation and continuing existence of large international capital obligations, the individual maturities of which were swallowed up in new loans made to the debtor countries, were at the heart of the world economic system. They were the fruit of a natural and inevitable process which was a healthy one for both parties. It spread a fertile top soil over undeveloped countries; and to England, the great creditor nation, it gave an abounding prosperity.

The pre-war prosperity of Britain rested primarily on the efficiency of its industry. Without that, its great system of world distribution and finance could not have been created. Beyond that, however, it rested on the enterprise and intelligent coöperation of other large sections of the population—on the merchant, the banker, the investor, the steamship operator, and the government servant. The result was to make England the trade centre and London the financial capital of the world.

It was industry which gave the original impulse to the business of foreign investment, and industry received, in return, an impetus from finance. British bankers came to know the business of foreign commodity financing and long-term investment as no

other bankers did. Not only did they make it convenient for foreign merchants to buy British cotton goods and cutlery; they made it worth while for foreign railways and manufacturing concerns to float their securities in England and to spend the proceeds there for rolling stock, rails, and machinery of British fabrication. The world acquired the habit of going to London for money, some of which, at least, might have been borrowed elsewhere, and by the influence of propinquity alone, much of the sterling placed to the credit of foreigners in British banks went back into British pockets. Thus more work was done in England, more exports were created, and the tide of British capital flowing to the ends of the earth was steadily augmented.

In 1913, Europe was still supreme in the economic system—at least, in its international manifestations. Europe's exports were 65 per cent. of the exports of all the countries of the world, and in transport and international finance its position was even more important. In industrial power it appeared to be holding its own, for the activity of Europe in the markets of the world gave impetus to its production. America was still a passive factor in the world system.

This great mechanism of industry, trade, and finance which in 1913 was operating smoothly throughout the civilized world—one part meshing properly with another—had been erected during a single uncompleted cycle of expansion. It had

never been subjected to any severe strain, nor had its functioning ever suffered any serious interruption. No one had the least idea as to what might be the result of such a test. Not only that, the workings of the machine as a whole, even in normal conditions, had not been grasped by the human mind. It had grown too fast.

Man had begun to wield powers not his own. He had begun to tap the fields of energy which had been kneaded into the earth by the titanic forces of creation. His works had become the transmission line of high-tension currents, the properties of which he had not plumbed and the velocity of which increased at a startling rate each time the door to nature's secrets was opened a little wider. The transformation of materials was no longer the work solely of man's own hands; and in proportion as the new forces employed in production were inscrutable, in similar degree the intricate systems of currency, credit, and exchange which had been created to give outlet to them surpassed man's powers of comprehension. More than that, the linking up of all civilized mankind into one great organism brought into active though largely unconscious relationship millions of widely separated individuals whose motives and activities could not be adequately catalogued. Vast new fields of social-economic phenomena insistently called for study and interpretation.

In an effort to establish intellectual mastery over

this new machine of man's creation, political economists had staked out a new department of knowledge. They began systematically to observe the habits of men engaged in making a living and to analyze statistically the operation of the multifarious parts of the machinery of production, trade, and finance. Upon statistical foundations, upon principles and theories borrowed from the physical and social sciences and upon the basis of independent speculative thought, the successors of Adam Smith strove to uncover a body of laws in the light of which the new system might be interpreted and controlled. They were still groping in comparative darkness when the new processes came to an abrupt stop, preparatory to a complete change, not in character but in direction. With incredible destructiveness, the war crashed into the European members of the machine; and suddenly the primacy of Europe was gone.

CHAPTER II

THE ECLIPSE OF EUROPE

WE SPEAK easily and casually of the new supremacy of America in the world system. We make a commonplace of a phrase, the implications of which are probably much greater than we suspect. To minds accustomed to the old order, a complete overturn in world relationships is not readily comprehensible. The eclipse of Europe is not appreciated at its reality. Europe's predominance is probably gone more completely and for longer than we are accustomed to think.

From month to month, almost from day to day, we look to see the Old World rehabilitated, the war debt controversies ended, and life in general restored to the comfortable arrangement of our provincialism, when the pains and rewards of world leadership passed us by. But from month to month and from year to year, the sickness and turmoil across the Atlantic continue. Europe shows a slow, but only a slow, improvement. We are annoyed at its perversity in not more promptly setting its house in order. We forget that to build is infinitely more difficult than to destroy.

The primary fact of the international situation resulting from the war is the substantial displacement of European products by those of the United States in the markets of the world. In 1925, the total volume of world trade (exports plus imports) had gotten back to the 1913 figure (i.e., 57 billion dollars, equivalent to the 38 billion dollars of the 1913 trade). But Europe's exports of 14 billions in 1925 (amounting to about 52 per cent. of the total exports) were a fifth less than they had been before the war; while those of the United States (amounting to nearly 18 per cent. of the total) were a third more than before the war.[1] Corresponding with this shift in trade, Europe, on balance, has ceased (in fact, ceased in 1914) to invest abroad, while the United States has begun to do so on a large scale. The function of producing and exporting a free surplus of goods has passed to America.

Two conditions make an early reversal of this situation unlikely. One is the fact that though Europe before the war led in the building of the world system of distribution and was accordingly supreme in transportation and finance, its primacy in production was even then being threatened by the United States. Europe clung to hand work, while the United States, in the seclusion of its

---

[1]The 1925 and 1913 export figures are compared on the basis of real values, i. e., after allowing for the approximate increase of 50 per cent. in 1925 prices over 1913 prices. Trade statistics from *Commerce Yearbook*, 1925, United States Department of Commerce.

domestic markets, had gotten a start of years in the electrification of industry. Europe now is making strides in that direction, but the still enormous resources of undeveloped water power and reserves of coal and petroleum in North America are the determining factors in the race. Their existence makes it unlikely that Europe can, in the near future, if ever, cut down the overwhelming lead of the United States in the process of "putting power behind the worker."[1] The second condition which will keep Europe for an extended period in the passive rôle once occupied by the United States is the extent of its capital losses.

The basis of economic health is capacity to produce, and the measure of that capacity lies in capital—in human capital or man power; in invested capital or stored-up labour, including plant, organization, and good will; and in natural capital, including land, water power, and mineral deposits. We have not had the habit of regarding Europe's post-war difficulties as arising from any such deep-seated condition as capital wastage. The economists have told us that the war was paid for while it was being fought. They tell us that in the economic sense it was paid for out of current production. We have accepted their dicta too readily. They seem to have overlooked the stupendous capital losses which Europe sustained in man power and invested capital.

[1]The phrase is Owen D. Young's.

Man power is the active factor in production. The powers of nature existing in steam and electricity increase the effectiveness of man power, but they have no independent existence as active agents in production. The semi-automatic machine has to have its operator. If man power is decreased, steam and electricity are proportionately incapable of being utilized. Man power, then, is the hammer and plant is the anvil of industry, with raw materials as their medium.

The agency which guides the hammer is organized intelligence—management and organization in all its varied aspects. It takes years to build organization—years of patient effort in fitting the right men into the right places, in perfecting methods, in building traditions. The training of artisans, the development of factory methods, the creating of purchasing and selling departments, the effective handling of financial and accounting problems—these elements all enter into the finely adjusted industrial machine as a form of invested capital, which, once dissipated, can be replaced but slowly. Closely resembling this factor of organization is a fourth capital factor which supplies much of the impulse behind production. It consists of that group of intangibles known as good will. Good will guides the customer to the product. Its creation on the world market represents long and costly effort; and its structure must be kept in constant repair.

In the four departments named—in man power, in plant, in organization, and in good will—it is plain that Europe suffered an enormous capital wastage as a result of four years of war. Statistics have not adequately conveyed the picture of Europe's losses to our intelligence, partly because of their very magnitude and partly because there are no statistics at all covering whole departments of the subject.

The human mind grasps the meaning of a million with some difficulty. But a billion is totally beyond comprehension. In the parlance of the day, it is merely "astronomical." It conveys no tangible picture. Perhaps the real effect of the war can best be grasped, though still imperfectly, from a picture in terms of a cataclysm of nature. Thus viewed, the war was a long-drawn-out eruption of some hundreds of volcanoes extending from Ostend to the Adriatic and from the Baltic to the Dardanelles.

In the near vicinity of these volcanoes were concentrated practically all the able-bodied men of western Europe, called there for the purpose of destroying each other. Into those hundreds of craters were poured all of Europe's consumable wealth which it was possible for the governments to lay hands on, together with much of that of the United States. Out of these craters, for more than fifteen hundred days on end, poured a rain of steel and gas, carrying to premature destruction 14 per cent. of the strongest and most active men of Europe—a

seventh part of its most effective human instruments of production. In this tide of destruction, most of the fixed property within range of the guns was also swept away. With this gigantic wastage of man power and plant went the dissipation of billions of productive assets in the form of organization and good will wiped out by the disruption of industry and trade, by the enforced remodelling of customers' buying habits, and by the reduction of customers' buying power. Besides all this, we must not forget, though we cannot guess at its extent, the great impairment of power in the population which survived—human endurance worn down and spiritual reserves exhausted by exposure, wounds, overwork, and a four-years' diet of horrors.

The effects of the human losses are probably much more serious than we have imagined. France lost in killed about $3\frac{1}{2}$ per cent. of her population, Germany about $2\frac{1}{2}$ per cent., and England about 2 per cent. In one family out of approximately every six in France, the principal means of support is gone. The subsistence, then, of six families, or approximately thirty persons, instead of being provided from the income of six heads of families or (counting other workers) of, say, nine full-capacity wage-earners, must now be found from the product of eight. As two of the surviving wage-earners sustained injuries during the war which decreased their productivity by, let us say, an eighth, we have seven and three-quarters earners now taking

the place of nine. The significance of this fact will bear examination, for it is by margins narrow as this that nations either prosper or are pressed down into degradation and economic sterility.

We may, however, first ask what likelihood there is of this condition being relieved in less than the time required for a new generation of males to grow to full maturity. The answer seems to be that there is little or no likelihood of it. Economists, gazing with speculative eyes on the women and children, theorize to the contrary, but they have few facts to offer in evidence. Their theories are based on the assumption that women and children will be forced into increased labour. But they overlook three important considerations.

The first is that physiology places relatively low limits on the industrial productivity of women and children, and that already, before the war, the output of those members, as everyone knows who has seen whole families working in the fields and the shops of continental Europe, was considerable. The second one is that their pre-war output, if not close to the limits set by physiology, was unquestionably close to those placed by powerful social sanctions, which increase their resistance as they are pressed back. Aspirations and convictions which are deeply rooted in the human breast tend to protect family life from disintegration and to keep women and children in the home. The third consideration is this: Where,

in spite of the protective influences, a mother is forced to neglect the home, or children are turned into economic machines, the partial replacement of lost productivity thus secured will prove deceptive. It is bound to be nullified over a period of years by the defective spiritual and physical stamina of the new generation. It is a reasonably safe assumption that there is no escape from the social and economic penalties attendant on the loss of male workers.

What, precisely, are those penalties? Estimates of the pre-war excess of production over consumption have placed it at 10 per cent. for France[1] and 20 per cent. for Germany. It seems unlikely that, in reality, there was that much difference between the rates of savings in the two countries. The German estimate made by Dr. Karl Helfferich of the Deutsche Bank has been regarded by students as an exaggeration resulting from influences of national pride. We may, perhaps, take 12 or 15 per cent. as a reasonable estimate for both countries and as indicative in a general way of the rate of earnings elsewhere in Europe. Now, our estimates relating to dead and wounded show that, in France, each full capacity wage-earner, assuming seven and three quarters such earners in a group which has been reduced by death from thirty to twenty-nine, supports four tenths of a person more than before the war, or an increase of about 12 per cent. A similar calculation for Germany shows an

[1] Estimate of René Pupin.

increase of about 9 per cent. Comparing these percentages with the estimates of pre-war rates of savings, we find that, from losses in man power alone, apparently little or nothing would be left for savings.

What conclusion, then, is to be drawn when, in addition, we consider the large capital losses in plant, organization, and good will? The anvil of production is damaged, the direction given to the hammer is less certain, and the impulse behind the blow is weaker. The results on industry are decreased effectiveness of labour, or unemployment, or both. These inevitable results have been delayed in their arrival (though replaced by other injurious effects) in those countries where industry has been artificially stimulated by progressive inflation of the currency. But they have been apparent from the first in England, whose currency suffered no large decline; they appeared in Germany in 1924, when the mark was stabilized, and at the end of 1926 they were beginning to appear in France. It seems clear that stabilization of currencies is not alone responsible for these phenomena. The English pound was brought back to par in April, 1925. Unemployment arising from a fall in prices due to stabilization might be expected of itself to be merely temporary. There is something more fundamental the matter with Europe than currency troubles. Europe's trouble is an impairment of earning power, resulting from a condition of serious capital depletion.

To rush to the conclusion that the Old World can save nothing over consumption, that it is economically sterile, or, in plain language, that Europe is dying, would be absurd. The riddle of that great complex organism is not so easily read. The intelligence and industry of its peoples are axiomatic. Europe is still functioning as a highly civilized part of the world machine, and it shows some improvement. All the precedents of history are that it will recover. The mind can scarcely conceive the contrary, for Europe is a fundamental fact in human experience. But at least it seems clear that the Old World has entered a period of prolonged eclipse.

It seems evident that, for many years, Europe will be hard put to it to make both ends meet. If it is to avoid economic sterility, consumption must be restricted. For many years, its small and painfully acquired accumulations must go to fill the hole in its invested capital. And when the assets representing that capital are physically replaced, as is already largely the case in the devastated areas of France, the end will not be then. Over a long period of years they must still be paid for by taxes of unprecedented size taken from the meagre income of the average man; for under the system of capital accumulation whereby we live, the sagacity of man has never yet been able to devise a method of taxation in which the burden has not

been distributed largely on a per-capita basis instead of on the basis of ability to pay.

For many years, heavy taxation will seriously depress the standard of living of European populations at large. The quality of their subsistence, the character of their facilities for recreation and improvement, and the ability to provide for old age will be impaired for a long time to come. And that condition will, in turn, react unfavourably on the already weakened earning power which causes it. For those things will have been impaired which are vital to the well-being and the contentment of the individual and the tranquillity of the state, and which are, in consequence, the broad bases of human efficiency and productivity. It would be a rash person who would assert that the road to the economic recovery of Europe will not be a long and difficult one.

Up to 1914, the movement of world economic currents was from Europe outward. The forces set in motion by the war were of such intensity as to bring that first great swing of the pendulum to a close. The United States, in developing its tremendous resources, in building its railroads, in opening the West and rebuilding the South, in finding employment for a rapidly growing population and giving play to the genius of its industrial leaders, had required vast amounts of new capital. It had none to spare to send abroad. It not only

ploughed back into new productive facilities all of its own large savings; it ploughed in, as well, a considerable portion of those of Europe.

In years of this process of consolidation, the industrial strength of the country had been developed to the bursting point. Suddenly, its power became dynamic. Responding to the insatiable demand created by the war, the United States, by an unheard-of productive effort, settled through the gigantic exports of the years 1915–1920 an adverse capital balance of 5 billion dollars[1] (equal to 7½ billion dollars in present-day values) and created a balance of 10 billion dollars on the other side, represented by the interally debts. Thus a cycle was completed. The productivity of the United States had been pushed far up and that of Europe had been pushed far down. America had become a natural creditor continent; and Europe, exhausted, had become a natural debtor. The long swing was to begin again, but in a changed direction.

On our side of the Atlantic, the upheaval which prostrated Europe left the country with its productive assets practically untouched and the consumptive capacity of its markets, which had been chiefly home markets, substantially undamaged. The post-war readjustment, while severe, was brief.

---

[1] "It is generally estimated that before the war the United States was a debtor nation to the extent of 4½ to 5 billion dollars. American securities of all types were held by foreign investors in practically all of the European countries."—Commerce Reports, July 18, 1927, United States Department of Commerce.

In industrial organization, the country had suffered a temporary derangement; in man power it had escaped with relatively few losses; in plant, it was stronger than ever. Physically, the nation was ready to take up its larger rôle in world affairs. But six years were to elapse before it could do so.

During the six years which followed the Armistice, we stood aside from European affairs, under the delusion that they no longer concerned us. We were in the throes of a reaction which was zealously fostered by the rabid isolationists. But by the close of 1923, when General Charles G. Dawes, Owen D. Young, and Henry M. Robinson were invited by the Reparation Commission to go to Paris to study and advise upon the reparation question, it had become clear to many that the condition of Europe was a matter of serious concern to the United States. It was becoming plain that the continuance of the European crisis presented to this country problems which were second in gravity only to those which it presented to Europe itself. In an economic scheme organized around the employment of large aggregations of capital, the Old World lay impoverished and inert; while the New World, piling up an idle surplus, faced an inevitable slackening of its industrial activity.

The United States was recovering from the crisis of frozen credits of 1921. The war had left industry with large stocks manufactured under the high-cost conditions of war. With the cessation of the war

demand and the accompanying drop in prices, these stocks could not be disposed of to the public at a profit or even at cost. Part of them were shipped to Europe for relief purposes, the money being provided by the United States government, which took in settlement the promises to pay of the Allied governments. The remainder was disposed of by industry at a loss. Mushroom industries were forced to the wall, and a general clearing-out process ensued. At the end of 1923, the process was practically completed and the country was back on a full-time working basis. It was producing an economic surplus over consumption which was sufficient to provide for domestic requirements for new capital and to leave a considerable surplus for export. Here was the American problem. If unemployment was to be avoided, the surplus had to be put into the channels of export trade.

Europe, producing barely enough for its own subsistence, desperately needing new capital in the form of American goods, for which our merchants wished nothing better than to take orders, was, in the modern sense, economically isolated. Our surplus, if it was to move, had to move against credit. But a violent controversy over the reparation question destroyed Europe's credit. Credit not only scrutinizes with a practical eye past earnings and present physical and financial condition; it also has a sensitive regard for intangible factors which may adversely affect future income. In 1923,

Europe was a poor psychological risk, and the world machine was at a standstill.

Tangled up with the reparation problem were countless questions of vital importance in the lives of millions. The common man of Europe worked, when he could get work, and made a precarious livelihood. Those who were idle by force of physical disability or the prostration of trade lived at the expense of the others, on pensions or unemployment doles. Industry pushed up sporadically where it could. But in the main, in all matters where the fate of industry and of the individual was bound up in broad questions of political, social, and economic policy, no real progress could be made while the reparation controversy raged. Confidence was dead.

During three years of a progressive drift toward anarchy, reconstruction had waited upon a solution of this key problem. It had waited upon the formulation of a programme and a body of principles relating to the reparation question which would be capable of inspiring universal confidence and of releasing at a single stroke all the regenerative forces of a normal economic régime. The Dawes Plan was such a programme and such a body of principles.

It was to furnish a channel for the movement of new tides of American economic power. In the markets of the world, these tides were to fill the gap left by the sudden decline of European industrial

power. In Europe itself, these tides of American capital were in some measure to heal the deep gashes in its material equipment, while nature, working through the birth rate, commenced slowly to restore the human bases of Europe's former productive power.

CHAPTER III

SOME FUNDAMENTALS OF THE REPARATION QUESTION

THE position of Europe at the close of 1923 seemed to be extremely precarious. To many competent observers it appeared that a catastrophe of the first magnitude was close at hand.

England, suffering from the continued disorganization of her trade and industry, was grappling with an ominous political situation arising out of unemployment and an overcharged budget. Labour leaders were advocating a capital levy, and the more violent of them were openly agitating for an overthrow of the existing form of government. A Labour Cabinet was now in office and in the opinion of many sober-minded Englishmen the outlook was very threatening.

In Germany, the cutting off of the Ruhr, with its steel and coal, had almost paralyzed the economic life of the country[1]. As a result of currency deprecia-

[1] "It was calculated that, at the date of the Franco-Belgian occupation, this patch of territory (the area actually occupied was about 60 by 28 miles) accounted for 80 to 85 per cent. of Germany's coal and 80 per cent. of her steel and pig-iron production, for 70 per cent. of the goods and mineral traffic on her railways, and for 10 per cent. of her population."—*Survey of International Affairs, 1924*, p. *269*, by Arnold J. Toynbee, Director of Studies in the British Institute of International Affairs, Oxford University Press, London, 1926.

tion, savings had been wiped out, earnings reduced, the Treasury bankrupted, and the population left with practically no medium for exchanging the necessaries of life. That Germany would drift into Bolshevism was the expectation of many.

France, shouldering a crushing load of public debt, seemed on the verge of fiscal collapse. The French had been in the Ruhr a year, operating the railways and coal mines of this rich industrial area for the account of their public treasury. The outlay connected with the enterprise had been considerable, and the profits were problematical. Poincaré was Premier, and among the neighbours of France the conviction was prevalent that he cared nothing for reparations. In England and in Germany he was widely regarded as the modern "man on horseback," leading the nation forward upon a career of military conquest which would bring fresh disaster to France and to her neighbours as well.

In all this sombre situation, the most sinister feature was the bitter and distrustful state of mind which pervaded it.

The hope of a prompt stabilization of Europe had rested, at the close of the war, upon the Anglo-French entente. Together, the two great allies could have led Europe toward peace. That hope had long since been dissipated. The entente had long since disappeared in a welter of recriminations.

During Baldwin's first premiership of a few months in 1923, the English Conservative party

had moved in the direction of conciliation with France. But Baldwin had been turned out of office on his programme of tariff protection. MacDonald, the newly installed Labour Premier, had not yet declared himself toward France. But the Liberals, upon whose votes in the House of Commons he depended for his continuance in power, were loud in their denunciation of the French. They demanded the evacuation of the Ruhr as a condition precedent to any dealings between England and her late ally.

The effect of this outcry was to harden the French in the belief that there was no safety in surrendering the pledges which they had seized. They believed that England would in no event support them in collecting the reparation debt, and they felt certain that, without such support, peaceful methods of realizing on their claims would fail. The French, in short, were standing pat and consolidating their positions across the Rhine.

Among the Germans, organized resistance to the occupation had ceased with the bankruptcy of their government. But German resentment still glowed with an intense heat. Superficially, at least, it appeared as strong as the deep sense of unredressed injury which animated the people of France.

Back of these symptoms of acute distress in western Europe was a profound economic exhaustion—an exhaustion more severe by any criterion than that from which our Southern states, after

1865, scarcely recovered in forty years. Europe had been living on its capital for ten years.

Of the great nations, France and Germany had suffered most from loss of man power; England (and in a measure Germany) from destruction of trade organization and sacrifice of foreign investments, and France from loss of plant.

By reason of the severity of their losses in man power France and Germany confronted a grave social-economic problem of a continuing character. That problem related to the ability of the remaining workers to provide properly for the feeble, the immature, and the mothers of growing children.

England was prostrated by the shattering of trade connections, the loss of foreign markets to the United States, Japan, and the neutrals, the impairment of the purchasing power of foreign customers, and the sacrifice of foreign investments. Several of England's largest customers—notably Germany—were in a state of collapse. The trade of the country was at a low ebb, and its industry languished. The war costs, however, had to be met currently in the form of interest on a huge public debt.

In northern France, about $6\frac{1}{4}$ billion dollars' worth of factories, mines, railroads, farms, and homes had been destroyed.[1] To replace them, to bring her physical equipment alone back to a pre-

---

[1]See Table V, Appendix. The original French estimate of these losses was about 6.7 billion dollars plus $800,000,000 interest to May 1, 1921.

war footing, France had turned her productive effort inward over a period of five years. The appalling wreckage in Artois, Picardy, and Champagne had been cleared away, and a new France was arising.

This achievement had been a great, a vital step toward the economic recovery of France. But it was only a first step, and in the sphere of international relations it proved almost fatal. The qualities displayed by the French people in their dire emergency were lost upon their neighbours. The very courage and vigour with which the work was prosecuted caused a reaction against the French abroad. The nation was busy, the ruins were being cleared away, and France, so the economic doctrine ran, was practically recovered[1]. This illusion of a rapid recovery turned powerful sections of English and American opinion against the French on the issues of reparations and interally debts.

The ruins of northern France had presented a convincing spectacle to the eyes of the first visitors after the Armistice. On the surface, the problem seemed to be a fearful one. It was such in reality. Foreign observers were mistaken in believing that a quick and easy solution for it had been found.

The alienation of a seventh part of France during the German occupation threw thousands of refugees into other parts of the country and took out

[1] "France . . . whining about devastated districts, which are easily repaired." J. M. Keynes, *A Revision of the Treaty*, London, 1922, p. 186.

of its economic structure for four years a tenth part of its tax-producing resources. This fact, together with the fact that France mobilized a larger percentage of her able-bodied males than any other of the great powers, was the reason why France came out of the war with a disproportionately large war debt. When the cost of reconstruction was added to it, a burden of public debt was saddled on the French people which, relative to the earnings of the population, was the heaviest in the recorded history of any great nation.

The ruins had been converted into taxes. But while ruins strike the eye, taxes are invisible. When the barbed wire had been rolled up and the shell holes filled, the dramatic appeal was gone; and with it, seemingly, all means of conveying a message to the intelligence of foreign observers. What we get through the eye we understand. The ruined householder, living in a dugout, had been an object of solicitude and a potential danger to civilization. But the troubles of the impoverished taxpayer were much less apparent, and the vital interest which the neighbours of France had in their alleviation was far less obvious. Many Englishmen and Americans were incensed by the occupation of the Ruhr. It outraged their sense of decency, and it was bad for business. That they themselves were in any way responsible for it did not occur to them.

The costs of the war to the five chief belligerents of western Europe (Great Britain, France, Italy,

Germany, and Austria-Hungary) were equivalent to about 60 billion pre-war dollars or twenty months' income of the 240 million people concerned.[1] Most of the war costs had been met by government borrowings and the small proportion of the costs which were covered by taxation was more than offset by debts carried over from the "armed peace." This colossal sum of 60 billion dollars may therefore be taken as representing roughly the public debt created by the war. It represented an orgy of instalment buying beside which the present practice in our country of buying useful luxuries against future income is small potatoes. The European taxpayer mortgaged his future, years ahead, for a large stock of munitions of war which he promptly blew up or otherwise consumed.

The problem of providing for the carrying charges on this mortgage placed before every government of Europe a problem of the utmost gravity.

At 5 per cent. the combined debt charges of the five countries would amount to a month's income of the population every year. Added to this, the normal national budget expenses on a pre-war basis (excluding debt charges) amounted to another month's income. If pre-war military charges could be reduced by half, the total national taxation un-

[1] Estimates by Harvey E. Fisk, *The Inter Ally Debts*, Bankers Trust Company, New York, 1923.

der the post-war régime could be brought down by the equivalent of a week's income. But, on the other hand, there would have to be added the burden of reconstruction, pensions, unemployment doles, and local taxes.

Taking everything into account, the obligation faced by the European taxpayer was a continuing charge over the next generation, amounting to 20 to 25 per cent. of his earnings. The average European faced the prospect of working without compensation for two and a half to three months out of every year. Considering that the per-capita income of the population before the war had been only about $150 a year, this charge constituted a threat of the first magnitude to the continuance of European civilization.

In England, France, and Germany, respectively, the actual conditions varied considerably from the average. They varied, first, in the amount of wealth and income per capita, which, at least before the war, had been highest in England, considerably lower in France, and slightly lower still in Germany. They varied also in the internal distribution of wealth, the spread between affluence and poverty being widest in England, somewhat narrower in Germany, and much narrower in France. They varied, again, in the size of the debt load, which was heaviest in France, appreciably lighter in England, and much lighter in Germany. Lastly,

they varied in the manner in which the debt load was carried.

In England, the debt burden was being carried by extremely heavy taxation, largely on income, which reached its peak in 1918–1921 and thereafter diminished. In France, it was carried by less heavy but constantly increasing taxation, principally on consumption, which in 1922 or 1923 overtook and passed the English figures, and it was partially carried until 1920 by a moderate inflation of the currency. In Germany, it was carried by an inflation of vast proportions which was the equivalent of a drastic hit-or-miss system of taxation imposed on all classes of the community except the owners of real property.

Only in the tangled array of statistics which generally support these broad statements were the true outlines of the reparation problem to be distinguished. At the time, it was seen through a glass darkly. Most of the facts were obscure, many of them still are. The English, the French, and the German peoples, each of them painfully aware of its own burdens, were ignorant of those of their neighbours. To bring about a prompt and rational settlement, the crying need of the world was for facts.

Unquestionably, facts or no facts, a certain time was required for the passions of war to abate. But that period was relatively short. For, in the heart

of the common man, the hope for peace was a far stronger force than any feeling of antipathy for his neighbours. The great obstacle to the stabilization of Europe was not passion but suspicion—that ages-old distrust of the foreigner which in Europe and America alike feeds on ignorance. Facts—economic facts—were desperately needed, and the decency of the common man might have been relied upon to do the rest. Here, economic science had its supreme opportunity to serve mankind greatly. That opportunity it failed miserably to grasp.

It was in England that the profession of economics had attained its greatest development and its widest influence over world opinion. It was there that its professors claimed with assurance to speak with authority on the economic aspects of reparations. English economists, from a wide platform, instructed the world on the reparation problem, and a considerable and influential portion of civilized mankind accepted their pronouncements at face value. Their views on reparations everywhere commanded the respectful attention to which science is entitled, and in many quarters they inspired that almost childlike confidence which men troubled by doubts repose in the expert.

Unfortunately, the layman did not know that it was a new kind of science to which he was surrendering his independence of thought—one in which research had become of secondary importance. He did not know that political economy had gone off

on an orgy of speculative thinking and political pamphleteering. Science was no longer science, but it carried no new identification tag by which the layman might be warned of the change.

The science of economics had suddenly been emancipated from the prosy business of dealing with facts. Its horizons had been gloriously expanded. Its professors felt an exhilarating sense of power, and some of them gratified it with reckless irresponsibility.

The reparation problem was summed up by British economists in three major doctrines, all of them supporting the idea of cancellation of the reparation debt. The first of them was the doctrine of British interest. It was to England's advantage, so it ran, that the reparation debt be not paid. This idea rested on the assumption that the debt payments would be made by Germany in goods. In the opinion of the economists, this would constitute a serious menace to British industries. Moreover, as they saw it, the internal debt about which the British taxpayer protested and for which he wanted partial relief from Germany was not a real national burden. The war, they said, had really been paid for out of current production, and the national debt was a "mere matter of internal distribution." More important to the public than any fancied relief to be gotten from tax reduction, they maintained, were the indirect benefits to be derived from shielding industry from an influx of foreign

goods on reparation account. Linked with these ideas was the political conception that the reëstablishment of favourable relations between Germany and England was more important to England than the restoration of France.

This new doctrine of British interest was a highly disturbing one to France, and it split England itself sharply into two schools: the economist, pro-German, Liberal school, and the taxpayer, pro-French, Conservative school.

The second doctrine was the doctrine of economic impossibility of debt payment. Most of the reparation debt would have to be cancelled eventually, the economists said, since foreign exchange difficulties would prevent the "transfer" of payments across frontiers. This being so, the argument ran, the debt, or the major part of it, should be cancelled immediately. Though nothing in the past history of international finance supported this theory, it was swallowed whole by the English intelligentsia, by their American disciples, and, not unnaturally, by the Germans. The French flatly rejected it.

The third doctrine of the economists represented an excursion into the field of ethics. The argument was that the legitimate interest of France in the collection of a large reparation debt was small; equitably, comparing the burdens of France with those of Germany on the one hand and with those of England on the other, France did not deserve much. The burdens of France, it was said, were in

large part imaginary, and its real burdens the nation was evading by inflation of the currency.

Coming from the mouths of men of science, this third doctrine was an amazing pronouncement. But it was an indispensable third in the cancellationist trilogy. England's interest, as the economists defined it, was thus securely buttressed, not only by the economic law, but by the moral law as well.

It was a well-rounded case. Though there was scarcely one good solid economic fact to support it, and though its chief political conception of abandoning France in favour of Germany was laden with high explosive, the argument had an immense vogue. In the eyes of powerful sections of the English public and of the American and neutral world, France was effectively photographed as an unintelligent and grasping creditor. For France still insisted on getting reparations.

Out of this new alignment of world opinion arose the desperate international deadlock of 1921–1924.

In the world-wide agitation for repudiation of the reparation debt which marked those years, no close observer will deny that it was the moral reproach against the French which was determining in the minds of the plain man. It was this third doctrine of the British economists which did the business. To the economic theories supporting cancellation, there was one wholly sufficient answer suited to practical minds—"Let us wait and see."

But the moral reproach would not permit of such temporizing.

If the facts were as stated, Germany was being badly treated. The reasons why France was to be regarded as so much better off than Germany were, it was true, somewhat abstruse, and there were some lingering doubts on this score in the mind of the plain man. But the contrast drawn by the economists between France and England threw the scales.

Here was an argument *ad hominem* which it was difficult for Englishmen to resist. Abroad, it was almost equally persuasive. The English taxpayer, it was said, was bearing heavier burdens than the French. If the English, generally regarded as a hard-headed race, could afford to forgive Germany her debts, the French must be actuated by motives which merited the condemnation of fair-minded persons.

There was one outstanding reason why the contrast drawn by economists between the sacrifices of Britain and those of France, to the discredit of the latter, was convincing to the casual observer. The forms of taxation adopted in England were more conspicuous than those in France. They were not more burdensome, but on the surface they seemed to be. This surface contrast in methods of laying taxes arose from profound differences in social structure which were and are inadequately appreciated.

In both England and France, social necessity dictated that a substantial part of the weight of taxation be lifted from the millions and placed on the well-to-do. In both countries, though in England especially, the dilemma was a grave one. The question was how to make this internal shift of burden effective.

The economic system by which the world lives is organized around concentrations of capital in the hands of the well-to-do. The system is delicately poised. Industry functions only through finance and credit. Capital is proverbially timid. Money markets and security exchanges are sensitive to any suggestion of legislative action having the appearance of an attack on capital.

Used in this sense, the word "confiscation" has come to have a special significance to the credit structure of a nation. Repeated often enough, the threat of "confiscation" results in panic, a crash in values, industrial stagnation, and trouble worse confounded. It is all psychological, but it has more substance to it than many more objective realities.

As an individual, the average well-to-do person, possessing certainly not less than his per-capita share of the intelligence of the race, is quite aware that the taxation of the rich in accordance with ability to pay bears, in reality, no closer resemblance to confiscation than does taxation of the poor in accordance with their ability to pay, or in excess of it. Being possessed of the average amount

of benevolence, he is doubtless willing, in principle, to act up to this conviction. In practice, however, he is in the grip of a mass psychology which fears to make voluntary concessions and is panicky at the thought of involuntary concessions. We are all, rich and poor and middle class, the creatures of mass psychology.

With conditions as they were after the war, however, the well-to-do had to conquer their febrile fears. They faced a situation in which concessions had to be made if worse things were to be avoided. The mass psychology of the millions constituted a truly formidable problem. The obvious danger from that source was direct action, which would bring in its train, not only panic, but conceivably real confiscation and not impossibly an overturn of the existing social system.

Now, the danger of an overturn seemed to be greater in England than it was in France. It was true that the average Englishman needed relief no worse than the average Frenchman. The per-capita debt figures demonstrate that fact. It is also probably true that the poor of England were no more poverty-stricken than the poor of France. But the English poor were more discontented. Few of them had any stake in the soil of the country, and, the wealth at the top being divided among fewer people than in France, the rich were richer in England than in France. They offered a more logical and conspicuous target and, by reason of

their fewer numbers, they offered, in the last analysis, an easier mark politically.

In England, the pressure from beneath to spread the tax burden higher up was irresistible. England was a nation of great and striking differences in fortune and conditions of life. Vast individual fortunes and land holdings of the nobility handed down unbroken from father to eldest son had been in existence for generations. A few thousand people owned the greater part of the land of England.

Moreover, great industrial fortunes had been created during the Nineteenth Century. The early development of the factory system had brought with it a form of industrial serfdom which those countries coming into the field later had been able in considerable measure to avoid. While much had been done before the war to relieve these conditions, much remained to be done. British labour had long been organized for a stiff fight, and, with the coming of peace, the issues of inadequate housing, of unemployment, and of high taxation precipitated the struggle.

The cry was for a capital levy. It was a new and untried expedient. No one knew precisely what it was, or how it was to be effected, or what its results might be. Labour had a vague idea that the public debt could be wiped out at one swoop, not by direct repudiation, but by a huge tax on property, to be applied to debt retirement. There were many technical objections to it, and one grave practical diffi-

culty. That crowning difficulty was that the mere threat of a levy would defeat it. The threat, if it became imminent, would cause a flight of capital abroad (such as happened in Switzerland in 1922) and end in a panic, the result of which would be a further collapse of the economic structure and greater and more widespread misery.

One of the two major alternatives to a capital levy was depreciation of the currency. But this expedient had already been tried elsewhere with disastrous effects. Its perils were apparent to most Englishmen, and the sentiment of the country as a whole condemned it. The other major alternative was a system of excise taxes on a large scale and broad basis—taxes on consumption. But as such a system resolves itself into taxation of the poor and tends to drive large sections of the population toward the social flash point, this alternative was not to be thought of. For it was obvious that in England the flash point was already very near.

This was the dilemma which England faced after the war and down to 1923. But the fact was that, during the war, the nation had already faced a similar dilemma, though, owing to the gravity of the external peril, a less acute one politically; and that the nation had extricated itself by adopting the principle of a capital levy in a modified form. It was by a system of estate taxes, a steeply graduated income tax and excess profit duties, that the revenues of the war period had largely been raised.

By these expedients, a considerable burden had been placed on capital. High death duties resulted in breaking up large estates, and high surtaxes and profits taxes considerably restricted the annual increase in industrial fortunes.

In 1923, such a system, though on a somewhat reduced scale, was still in force. It did not furnish a complete answer to a problem which, in England as elsewhere in Europe, can be solved only over a long period of years. But it seemed to be about the best that could be done. Labour came gradually to see the situation in that light, and after 1923, even though a Labour government had come into office, little more was heard of the project for a capital levy. The determining influence in this conclusion of the matter, be it noted, was the substantial lessening of tension throughout Europe which early in 1924 resulted from the formulation of the Dawes Plan.

England, then, had adopted during the war, and was continuing afterward, a system of taxation levied directly and in readily recognizable form upon that class of the community which was best able individually to bear it. The nation was redressing some of the marked inequalities of social condition such as France had remedied in 1789. England was laying taxation in the only way in which she could lay it and survive. Social justice required it, the millions demanded it, and the governing classes bowed to the inevitable.

Meanwhile, France was carrying her burdens in

the less conspicuous manner appropriate to her social and economic structure and fiscal habits. France, as Ambassador Bérenger has said,[1] was "essentially a country of moderate fortunes." The distribution of wealth was more even there than in England, Germany, or the United States—a condition, it might be observed, which alone constitutes an impressive reason for rating France as the most highly civilized nation on earth.

France was predominantly agricultural. Nineteen per cent. of the population owned their own homes as opposed to one half of one per cent. in Great Britain.[1] The average size of property held by a single owner was 30 acres as opposed to 410 acres in England.[1] Registered government bonds were held by 1,320,000 persons and out of 150,000 registered stock certificates of the great railway companies outstanding in 1911, 100,000 were certificates of less than 10 shares.[1]

Relatively to England, there were in France no great fortunes to tax. There were no great political reputations to be made by leading in the assault on wealth and the capitalistic system. There were no spectacular fiscal *coups de théâtre* to exploit.

Taxation in France was all quite humdrum—taxing consumption in accordance with the traditional methods of collecting taxes in France, taxing the commodities of trade (through the turnover tax) 1 per cent. to 10 per cent. of their value on every

[1] H. Bérenger, Statement to U. S. Debt Funding Commission, March, 1926.

sale, and levying high special taxes on "luxuries," on tobacco, beverages, and sugar, and on railway traffic and documents. The sources of national budgetary revenue included a considerable direct tax on real and personal property. But the direct income tax, as such, was a new thing in France, and it was only toward the end of the war that it began gradually to replace, in its yield, some of the headings of indirect taxation.

The total yield of taxation in France during the war had been considerably less than in England. For a large part of the most productive territory of the country had been held for four years by the Germans. Moreover, a higher percentage of the productive population had joined the colours than in any other of the great belligerent nations.

It is true that France had had a source of revenue in the British and American expeditionary forces. But it is questionable whether that advantage was not offset by the confusion and disorganization incident to having the country the active base of operations of millions of foreign soldiers. And while the presence of Allied troops on French soil stimulated small trade, the great munitions industries which supported them and manufactured much of the material required by the armies of France herself were in England and America. England was able to produce far more munitions than France, and through the excess profits tax on her industries, to raise billions more in revenue.

After the war, the scale of French taxation mounted steadily, year by year, until at the time of the Ruhr occupation the actual tax collections had reached a figure which probably bore about the same ratio to income as taxes in Britain. Since then, in the opinion of competent students, that ratio has increased to a figure greater than the English figure.[1]

Now, it was perhaps arguable in theory that, owing to the wider spread of wealth in France, an average tax burden higher than the English burden could be carried. A practical reason why this would be impossible lay in the political difficulties of taxing such a numerous class of the moderately well-to-do. Unless they were taxed by the medium of inflation (and with inflation there is always the danger of its becoming progressive and finally utterly destructive) those difficulties were bound to be very great and tend toward paralysis of government. The reality of difficulties such as these has been apparent in the recent governmental experiences of France, where Cabinet after Cabinet has been overturned on the question of taxation. Peanut politics, some say. Great political forces, the historian might reply—forces such as have cost

[1]Present estimates of French taxation are about 20 per cent. to 22 per cent. of income; British about 18 per cent. to 20 per cent. On March 14, 1925, the *Economist* (London) estimated 17.7 per cent. of income for France, and 17.1 per cent. for Great Britain, pointing out that figures of taxation per head are utterly meaningless unless related to income. The present writer's 1922 estimates (*Foreign Affairs*—New York, September 15, 1923, p. 72) of 18.3 per cent. for France, and 20 per cent. for England were, he believes, the first attempt to bring this truth home to students of the reparation problem.

kings, both French and English, their heads and changed the course of history. Stubborn economics facts, the modern political philosopher would call them—facts deeply embedded in human nature, whether it be Latin or Anglo-Saxon.

If, however, these political difficulties of carrying a heavier burden of taxation in France than in England could be ignored, there would still exist the same economic dilemma to which reference has already been made.

A large part of the burden of taxation, whether it be in France, England, Germany, or our own country, falls on the ultimate consumer, that is to say, on the poor man, and cannot be shifted. This situation is part and parcel of the dilemma of capitalism—of a society which functions only through great concentrations of unconsumed wealth. The considerable part of taxation which to-day is shifted upward on wealth in Europe is the excess burden which the poor, with their great potential power, have point-blank refused to carry and which has been accepted by the prosperous as the best compromise looking to the safeguarding of the social order. It follows that a higher average burden in France would either fall on the poor, with the attendant social dangers of such a happening, or, if rejected by them, would render the situation of business and industry correspondingly more acute in one of the key nations of the Western world than in the countries of its neighbours.

During and after the war, France carried part of her load of public debt by a depreciation of the currency which brought the franc down in internal purchasing value by 1920 to about a fifth of its pre-war value. Thus, the effective value of all fixed obligations remaining from pre-war days, including government bonds, was correspondingly reduced, and obligations incurred since 1914 were reduced in substantial though lesser proportions, depending upon the value of the franc at their date of issue. By this means, a special levy of considerable proportions toward the extinction of the public debt was made on the creditor classes of the community.

All things considered, this partial depreciation of its currency was probably the most suitable means that could have been employed in France for carrying a fiscal charge to a numerous class of moderately well-to-do citizens. It came about with a peculiar inevitability, like that of the taxation process which was under way in England. In each country, the conditions which required rectification carried within them their own antidotes, and as those conditions increased in intensity, the inner seeds of reaction bore fruit.

The wealth of the governing classes of England hung in gilded clusters, ripe for the picking. Its ostentation stimulated the idea of direct attack; and the numerical weakness of its owners made such an attack politically irresistible.

The wealth of France was less obtrusive. It was

wider and thinner spread. Individually, the rich obviously had less to give. The stimulus to an assault by direct taxation was correspondingly less, while the power of political resistance to attack was greater. But that power carried its own seed of destruction. It was responsible for the inability of the government to collect higher taxes, and thus for the depreciation of the currency. When this occurred, the circle was completed and an indirect levy was laid, willy-nilly, upon the property of those who wielded the obstructive power.

While this was going on, by some curious process of thought in the minds of foreigners, a stigma of fiscal ineptitude and lack of civic virtue was fastened on the French people. The nation, it was said, lacked the courage and the intelligence to put its public finances in order.

The evidence of that fact in the minds of critics of the French was inflation. It could have been nothing else. It could not have been direct repudiation, for France did not repudiate its debts. It could not have been the raising of immense internal loans for reconstruction. For at least an elementary knowledge of the difference between capital and income is common to most people, and that knowledge made it apparent that reconstruction, as a major capital operation, had to be financed by loans and not by taxation. Inflation, however, was a new phenomenon to the present generation. Loose thinking assigned an ethical significance to it. In-

flation was a form of evasion, so it was said, and from that point it was easy to read into the firm attitude of France regarding reparations something highly detestable.

It is clear that this was an untenable idea. It ignored the fact that no evasion of the burden of an internal debt—neither by depreciation of the currency nor by direct repudiation—is possible. The debt burden of France was as truly carried by the nation as a whole, through taxation plus inflation, as was the debt burden of England carried through taxation alone.

Some critics of the French avoided the absurdity of preferring a national indictment by making the charge of civic cowardice personal to legislators and ministers intrusted with fiscal responsibilities. Superficially, there was colour for such a charge. For, by inflation, although a part of the burden is shifted from the poor to the holders of government bonds, a new burden falls on the poor until such times as wages are adjusted upward and catch up with prices. Thus, for a period, even by a moderate inflation, the poorer classes suffer a punishment which might be obviated by out-and-out taxation.

The question is, what moral responsibility attaches to ministers and lawmakers for this result? That some measure of responsibility exists seems obvious. But it may be questioned whether the mind competent to assess it has yet appeared in judgment. Where the responsibility of the public

servant ends and where sheer impotence to stem the movement of political forces begins, this writer, at least, cannot undertake to say.

Whether in post-war Europe any considerable element of free will remains in the administration of parliamentary government is a question which the political philosopher might well hesitate to answer in the affirmative. Whether the virtue of a Lloyd George, carried to political success with the tide which washed over the landed nobility of England, was superior to that of a succession of French finance ministers who were swept out of office by the votes of the bourgeoisie is a nice question in comparative ethics.

Did the moral reproach, then, which aligned half the world against the French have special reference to the attitude of the more prosperous classes of the community? Here, again, the judicious are on difficult ground. Did the element of free will so predominate in the sacrifices of the rich in England as to justify the scorn directed against the middle-class Frenchman who took his medicine involuntarily by the inflationary method?

In reply to all such questions, a layman might suggest that the issue of moral turpitude never seems so clear as when the facts are obscure and the motives which are being judged are those of individuals of another blood and language.

The reparation controversy which prostrated Europe reached its height in the years 1921 and

1922. A condition of economic exhaustion was at the bottom of it. Taxes were the measure of that exhaustion. The world at large had come to the mistaken conclusion that the burdens of the French had been exaggerated or that in some way they were being evaded. An inevitable conflict was precipitated, which, with the occupation of the Ruhr in 1923, moved rapidly toward a crisis. In the autumn of that year came the movement to enlist the assistance of America in grappling with this threatening situation.

CHAPTER IV

EUROPE AND THE DAWES COMMITTEE

THE reparation controversy waxed to its peak at the end of 1922, and then, after an interval of desperate though practically bloodless warfare in the Ruhr, moved forward toward a settlement. The background of the controversy was one of extreme economic exhaustion. Its driving force was a clash of uninformed popular convictions on the rights and wrongs of the reparation settlement made by the Treaty of Versailles.

The formal channels of this controversy were those of diplomacy. The chief of these were the deliberations of the interallied Reparation Commission created by the Treaty. The Commission sat at Paris. Its principal functions were to fix the reparation debt and to prescribe terms of settlement.

The Commission was bound by the provisions of the Treaty to assess the debt at the amount of property damage caused to the civilian populations of the Allied nations by Germany, plus a sum sufficient to produce an income equal to the Allied pension charges and separation allowances. In pre-

scribing the terms of payment of the reparation debt, the Commission was to be guided by the principle that Germany's tax burdens should be "fully as heavy proportionately" as those of the Allied nations. It was also to take into account Germany's "resources and capacity."

On May 1, 1921, the Commission had fixed the German debt at a figure which, after various deductions to be determined, would finally amount to about 31 billion dollars. The debt was divided into three categories of priority, each represented by bonds given by the German government. The bonds of Series A and B together amounted to about 12½ billion dollars.[1] This was the active debt, on which a schedule of payments was prescribed. The remaining debt, Series C, amounting to about 18½ billion dollars, was to be inactive.

The Commission was unanimous in fixing this debt, and it was unanimous in fixing at the same time the schedule of payments for its discharge. The Germans were required to pay interest at 5 per cent. and a sinking-fund contribution of 1 per cent. per annum on the 12½ billion dollar debt. This charge amounted to $750,000,000 a year. It was to be paid by instalments amounting to $500,000,000 a year, plus a sum equal to 26 per cent. of Germany's exports. During the first year, the latter sum amounted to about $275,000,000. Together, therefore, the two instalments would

[1]Fifty billion gold marks.

have exceeded by $25,000,000 the amount required on the active debt. If this had continued, and Germany had met the instalments, the excess would have gone toward the inactive debt. On that inactive debt—the C bonds—no obligation by Germany was to arise except in this way, and only to the extent which these supplementary payments, arising out of an increase in German exports, would discharge.

This situation, however, did not continue. The original instalment requirements for the twenty months ended December 31, 1922, would have amounted to 1,100 million dollars, or at the rate of $660,000,000 a year. The Commission, however, unanimously reduced them for the year 1922 to $542,500,000. The revised total instalments required for the twenty months amounted to about $875,000,000. Against this, Germany actually paid, during that period, $645,000,000,[1] or at the rate of about $387,000,000 a year.

[1]Technically, $80,000,000 of these payments was applied, not to the reparation debt, but to costs of armies of occupation during the period, discharging the latter in full. Prior to the Dawes Plan, the costs of the armies were an additional charge on Germany over and above the reparation payments. In 1922, these costs had been reduced to $50,000,000 a year.

German deliveries of cash and materials from November 11, 1918, to May 1, 1921, were applied to costs of armies of occupation during the pre-May 1, 1921, period. Those costs (excluding $250,000,000 for the U. S. Army) amounted to about $533,000,000 and the deliveries came to $558,000,000. (The Germans also repaid $98,000,000 loaned to them in order to finance deliveries of coal.) State properties ceded in Poland, the Saar, Dantzig, etc., to the value of $638,000,000 were credited to Germany in reduction of her capital obligation for reparations.

During the whole period from November, 1918, to December, 31, 1922, France, after being reimbursed for her army costs and loans to Germany, had received about $73,000,000 toward reparation. This, however, was not in liquid form, as it corresponded with the valuation of the coal mines ceded by

These facts and figures show in outline the financial aspects of the reparation problem as they stood at the end of 1922. In four years' time, Germany had paid in cash and deliveries in kind about 1,200 million dollars, about half of which had gone toward costs of the armies of occupation. Owing to inter-allied arrangements, most of the remainder had gone to Belgium. France had realized nothing in liquid form which could be applied to her costs of reconstruction.

It was in this situation of affairs that the German government, on November 14, 1922, asked for a moratorium of three to four years, excepting for certain deliveries in kind for the devastated areas, and that the English government six weeks later made the same proposal, plus cancellation of the C bonds.

Germany in the Saar. During the same period, England had received $28,000,000 toward reparation, Italy $50,000,000, and Belgium $634,000,000. Ninety-eight million dollars of the valuation of deliveries of merchant vessels by Germany had been written off by the Reparation Commission to profit and loss on the somewhat abstruse theory that the ships had more value to Germany who delivered them than they had to England to whom Germany delivered most of them. This amount, therefore, was not included in the charges made to Great Britain. A similar procedure was followed in connection with the value of the Saar mines, which were credited to Germany at $100,000,000 and charged to France at $75,000,000.

From January 1, 1923, to September 1, 1924, the date the payments under the Dawes Plan commenced, Germany was credited with an additional $123,000,000 on reparation and army cost accounts. This included various adjustments and brought the total payments by Germany since the Armistice to $2,007,000,000 (exclusive of repayment of coal advances), divided as follows: $674,000,000 representing the valuation of State properties ceded and applied in reduction of the capital reparation debt; $588,000,000 in liquid deliveries toward costs of armies of occupation and commissions of control (costs amounting to $663,000,000); and $745,000,000 toward interest and amortization of the reparation debt for the three years and four months from May 1, 1921, to September 1, 1924.—See official published statements of accounts of the Reparation Commission.

These were the culminating incidents of a long series of fruitless negotiations which had been going on for three years. They filled the French with apprehension. German payments were dwindling, and French expenses were mounting. In addition to being confronted with a proposed cessation of current payments, the French were asked definitely to renounce their future contingent claims on a large part of the capital debt. It was a proposal which no French government could have accepted and survived.

The formal cancellation of a debt on which the French had made no effort to collect was thus forced into the foreground as the acute issue of the reparation question. British financial and official opinion was thoroughly convinced that the mechanics of international settlement would make the "transfer" of any payments on the C bonds impossible and that the credit of Germany in the world investment market could not be restored while that part of the debt hung over her. The French took no stock in any of this. In their opinion, the practical exigencies of the situation did not permit of discussion of the future of the C bonds. Their reply to the cancellation proposal was "Let us wait and see."

It was on this rock that the Paris conference of early January, 1923, foundered, and Britain and France parted company. At that meeting, Bonar Law, the British Premier, made cancellation of the C bonds the price of British coöperation in the

solution of the reparation problem. Poincaré rejected it.

Immediately thereafter, the British adopted a policy of abstaining from the principal debates and decisions of the Reparation Commission. Germany was in default on her deliveries of coal and other materials. The Reparation Commission declared the default a voluntary one, and the French, supported by the Belgians, on January 11, 1923, moved into the Ruhr.

Upon entering the Ruhr, the French and Belgians disclaimed the intention "of proceeding at the moment to operations of a military nature or to an occupation of a political character." They announced their purpose to be to insure by their own engineers the fulfillment of the programmes of coal deliveries on reparation account which were in arrears. They formally based their action on the declaration by the Reparation Commission of voluntary default by the German government, which, under the provisions of the Treaty, gave the Allies the right to take measures which "may include financial prohibitions and reprisals and in general such other measures as the respective governments may determine to be necessary in the circumstances."

The German government denounced the occupation as an act of lawless violence, maintaining (as did the British) that the provisions of the Treaty, relating to the rights of the "respective" govern-

ments, contemplated joint action by all the powers represented on the Reparation Commission and not separate action by individual governments.[1]

The German government announced its intention to defeat, if possible, the purposes of the occupation. It suspended all reparation deliveries to France and Belgium, called upon all German citizens to refuse assistance to the forces of occupation, and entered upon a programme of financial aid to those who by reason of passive resistance were deprived of means of support. The desperate contest was marked by wholesale evictions of German resisters from the Ruhr territory. It was prolonged until September 28th, when the German government unconditionally threw up the sponge.

Months before the final collapse, however, Germany began to feel the pinch of the occupation very acutely, and in May, and again in June, asked the Allies for a new survey of the reparation problem.

On behalf of France, Poincaré replied that no proposals could be entertained until passive resistance should cease. He laid down other conditions relating to guarantees and the preservation of the rights of the Reparation Commission. An exchange of letters ensued between Lord Curzon, the British Foreign Minister, and Poincaré. It started with an

---

[1]For the German point of view on the occupation, see *The History of Reparations*, by Carl Bergmann, Ernest Benn, Ltd., London, 1927. Herr Bergmann had long and intimate contact with reparations.

attempt to find common ground, but in a few weeks' time ended with a frank abandonment of the effort. The two notes which in August closed the correspondence were plainly for the record only. They constituted a complete restatement of the positions of the respective governments and were entirely innocent of any attempt at reconciliation.

In vigour and acerbity of language, these letters surpassed all previous interchanges between the two allies. The Reparation Commission, Lord Curzon said, was "notorious" as an instrument of French policy. The Commission, Poincaré retorted, was acting in behalf of creditors (i.e., France and Belgium) who held 60 per cent. of the claims against the bankrupt, while Britain had only a 22 per cent. participation. Curzon summed up his conception of the reparation problem in the naïve assertion that the maximum which Germany could pay was a "question of establishing a fact." To this, Poincaré replied by insisting that the burdens of France were an integral part of the problem, and he rejected as absurd any attempt to estimate "once for all" Germany's capacity to pay. Curzon ended by intimating that Britain would be forced to take "separate action."

With this empty threat, a distinguished career ended in futility. Curzon was wholly unconscious of the dimensions of the reparation problem. Content to act as a megaphone of the economists, he was apparently unaware that a large inarticu-

late body of British opinion remained unconvinced of the correctness of the diagnosis of the economists and would not tolerate the idea of coercion of the French. His threat fell flat.

The false note struck by Curzon marked the turning point in the reparation controversy. It brought a fresh mind into the arena—that of Baldwin. It was Baldwin's first premiership. Though he had been at the head of the government for three months, he had moved very cautiously in the matter of displacing Curzon in the direction of foreign affairs. Curzon had been at the Foreign Office through several administrations, and had been Baldwin's chief rival for the Conservative premiership when Bonar Law had retired. It was not until the final collapse of Curzon's policy that Baldwin was able to give play to his own superior talents as a diplomat and man of affairs.

Before entering politics, Baldwin had been a leader of industry, with a broad and humane outlook on life. After the war, he had given up a fifth part of his fortune to the Treasury. He had the practical gifts of a conciliator, and he used them now to good advantage.

On the 19th of September, 1923, on his way to London from Aix-les-Bains, where he had been taking the waters, the British Premier stopped at Paris and had a personal interview with Poincaré regarding the reparation question. At its close, the two Premiers announced that, while it was not to

be expected that in the course of one meeting they could "settle upon any definite solution . . . they were happy to establish a common agreement of views and to discover that on no question is there any difference of purpose or divergence of principle which could impair the coöperation of the two countries upon which depends so much the settlement and peace of the world."

This announcement was a great and welcome change from the acrimony which had preceded it. The event which it marked was one of the sort upon which international conciliation is built. It was, in fact, the first step toward the creation of the Dawes Committee, and in spirit it was the forerunner of the spirit in which the Committee was to work.

It recognized the profound truth that conciliation must start at points of mutual understanding, however limited, and work cautiously outward, with the object of gradually extending the area of agreement. By a face-to-face meeting of principals, an attempt had been made by the two Premiers to provide the proper atmosphere for a settlement. The announcement was evidence that the attempt had been crowned with a considerable measure of success.

But in the precise form which the attempt had taken, nothing directly came of it. It fared very badly in England. The Liberal party, embracing the economist school within its limits, would have

none of it. The Premier, they said, was a dangerous amateur, rushing into a highly technical controversy without proper expert assistance. Moreover, such negotiations with the invader of the Ruhr were morally compromising.

Baldwin found the opposition too great, and he carried the project no further in that particular form.

It was only three weeks later, however, that he found an opening of another kind—one which was to lead Europe out of the morass. On October 10, 1923, President Coolidge publicly reaffirmed a proposal which had been made by Secretary of State Hughes the previous December, that a committee be formed of men of "prestige, experience, and honour" for the purpose of recommending a reparation plan to the interested governments. The Baldwin government promptly asked the American Secretary of State whether the United States would participate in such an undertaking.

On October 15th, Hughes replied in the affirmative, intimating that, while the American government was "not in a position to appoint a member of the Reparation Commission," there was "no doubt . . . that competent American citizens would be willing to participate in an economic inquiry, for the purposes stated, through an advisory body appointed by the Reparation Commission."

Interallied negotiations were reopened. In the course of them, Poincaré, referring to the vexed

question of cancellation, stated with great positiveness that France would not surrender the right of veto which, on the subject of cancellation, the Treaty gave to the delegate of each of the governments represented on the Reparation Commission. At this crisis, Baldwin, in the face of renewed criticism at home, saved the situation. He was statesman enough to know that a definite move toward appeasement was desperately necessary. But to accomplish it he had to ignore the warnings of the economists and other bitter-enders at home.

The British expert view was that no good could possibly come of an inquiry upon which any limitations were placed, particularly as to the power to recommend the cancellation of some part of Germany's capital obligation. But Baldwin preferred to open negotiations on any basis at all rather than prolong the deadlock which was paralyzing Europe. Baldwin was a believer in men rather than formulæ. To him the Committee was the thing, rather than the authority with which it should be clothed. In the last days of his administration, before turning the seals of office over to MacDonald, he took the responsibility of disagreeing with his technical advisers and consented to the formation of a committee with limited powers.

The governments being agreed, their representatives on the Reparation Commission decided on November 30, 1923, to convene two advisory committees, the first of which became known as the

Dawes Committee and formulated the Dawes Plan.

The terms of this decision were as follows:

"In order to consider, in accordance with the provisions of Article 234 of the Treaty of Versailles, the resources and capacity of Germany and after giving her representatives a just opportunity to be heard, the Reparation Commission decided to create two committees of experts belonging to the Allied and Associated countries.

"One of these Committees would be intrusted with considering the means of balancing the budget and the measures to be taken to stabilize the currency.

"The other would consider the means of estimating the amount of exported capital and of bringing it back into Germany."

Under this charter of a single sentence, in which the word reparations was conspicuous by its absence, the Dawes Committee, officially styled as the First Committee of Experts, came into existence.[1] Its ten members were appointed by the Commission on nomination of their respective gov-

[1]The second or McKenna Committee constituted to report on the amount of German assets held abroad was composed of the following bankers: Rt. Hon. Reginald McKenna, chairman of the Midland Bank, and former Chancellor of the Exchequer, chairman; Henry M. Robinson, chairman of the First National Bank of Los Angeles; André Laurent-Atthalin of the Banque de Paris & Pays-Bas, Paris; Dr. Mario Alberti of the Credito Italiano, Milan, and Albert Edouard Janssen of Brussels, Director of the National Bank of Belgium.

ernments. The majority of the members of the Committee were business men.

The American government suggested the names of General Charles G. Dawes and Owen D. Young, and by interallied agreement the former was named by the Reparation Commission as chairman. General Dawes was chairman of the Board of the Central Trust Company of Illinois at Chicago. He had served during the war as chief purchasing officer of the American army in France and had recently organized the budget system of the United States government.

Mr. Young was chairman of the Boards of the General Electric Company and the Radio Corporation of America and a director of the Federal Reserve Bank of New York. He had participated in the President's Unemployment Conference in 1921. Both the American appointees had had a legal training.

The four European delegations were each evenly divided between business men and professional economists. Sir Robert Kindersley was a leading banker of London and a director of the Bank of England; Sir Josiah Stamp was a British economist and statistician of note. Jean Parmentier was a banker of Paris, formerly a permanent official of the French Treasury. His colleague, Edgar Allix, was a leading French economist. Dr. Alberto Pirelli was head of a large manufacturing industry at Milan, while Dr. Federico Flora was Professor

of Finance at the University of Bologna. Emile Francqui of Brussels was a conspicuous figure in the industrial and financial life of Belgium, and his colleague, Baron Maurice Houtart, was a high official of the Belgian Treasury.[1]

The names of these appointees were well received in their respective home countries. Few of them, however, were well known abroad, and no distinct impression regarding the competence of the Committee as a whole was, therefore, at the time obtainable.

The general opinion, pieced together from the various national estimates of individual members,

[1]Technical advisers were called in by the Committee from time to time and representatives of the German government and of German industry, finance, labour, and agriculture were heard. Conspicuous among the persons consulted were Governor Montagu Norman of the Bank of England; Sir Arthur Salter, head of the financial and economic section of the League of Nations; Chancellor Marx, Foreign Minister Stresemann, and Finance Minister Luther of the German government, and Dr. Hjalmar Schacht, president of the Reichsbank. The British and French members were in direct contact, respectively, with Premiers MacDonald and Poincaré. The Committee had the continuous assistance of Sir Andrew McFadyean, the able general secretary of the Reparation Commission, and several experts, including Sir William Acworth and Gaston Leverve, respectively English and French railway specialists.

The American members had the invaluable assistance of Colonel James A. Logan, the American unofficial observer on the Reparation Commission, and of Ambassador Houghton at Berlin and Ambassador Herrick at Paris. They were also assisted by a competent staff of technical advisers, of whom Rufus C. Dawes, of Chicago, brother of General Dawes, was designated as chief, and Stuart M. Crocker, of New York, as secretary. This staff included Edwin W. Kemmerer, Professor of Economics at Princeton University; Joseph S. Davis, Professor of Economics at Leland Stanford University; Walter S. Tower, commercial attaché to the American Embassy at London; Chester L. Jones and Charles E. Herring, who occupied similar positions at Paris and Berlin respectively; and Alan G. Goldsmith, chief of the western European division of the Department of Commerce. Mr. Robinson, on the second committee, had as assistants John E. Barber, vice president of the First National Bank of Los Angeles, and L. P. Ayers, who had been chief of the Statistical Bureau of the American army and an economic adviser to the American Commission to Negotiate Peace.

was that the Committee was probably an excellent one, as committees go. The new interallied body was greeted with what its friends described as a "restrained optimism." This optimism was, in fact, so well under control as to amount to a chilling lack of confidence. Europe accorded the Committee a respectful welcome, paid tribute to the courage of its members, and returned to the contemplation of a vast drama which seemed to be moving relentlessly to its final catastrophe.

We now know that the Committee was a strong one, but at the time of its formation, the elements of its strength were not so apparent as the factors which pointed to failure.

Like every interallied body that had dealt with the reparation question, it had the great handicap of diversity of nationality. It was true that, in its political aspects, that difficulty was partially eliminated by the attitude of noninterference which the governments adopted toward their respective nominees. The American members were absolutely unhampered. While the same thing could not be said of the European members, it was apparent that the heads of their governments were prepared to accord them a considerable measure of independence.

But no one was so simple as to believe that they could be entirely free from the prejudice of race. No one felt able to predict that they would be able to break away from the tradition of interallied sus-

picion which had grown up around the reparation problem and see national interest in terms of international coöperation.

More than that, in the ten members of the Committee was represented a great diversity of training and habits of thought. Such a membership of course enjoyed the potential advantage of bringing to bear upon the reparation problem both the practical and the academic types of mind. But the question was, could the two types work together and achieve a constructive result, or would these talents be wasted in a fruitless clash of wills?

Could it be assumed that the business-men members were not of that considerable class of successful men of affairs who are ashamed to be thought capable of entertaining an abstract idea? Could it be assumed that their academic colleagues were not of the type that regards any recognition of realities as intellectually compromising? Few persons in Europe felt able to assume anything so hopeful as either of these things about the new Committee.

Lastly, it was apparent that the charter of the Committee was an extremely feeble one. It had a mandate to treat nothing but symptoms. It was asked to "consider" the situation of the German currency. But if it was to deal successfully with the chaos in the German fiscal system, it had to cure what lay behind it. It had to find a means of relieving the paralyzing bitterness of the reparation

dispute and a working arrangement pointing to a solution of the whole reparation problem. It lacked clear authority even to explore in those directions.

It was the French who were responsible for the general inadequacy of the Committee's charter. They were frankly skeptical of anything acceptable coming out of a project of British origin. The British, for their part, were equally skeptical, because power had not been specifically given to the Committee to reduce the amount of the capital reparation debt. In the home of its friends, in British official and financial circles, the Committee was believed to have been stillborn.

In this attitude of Europe toward the Committee and its task, it was difficult to recognize any of the faith which moves mountains. It was apparent that if the Committee was to break through the limitations of its constitution and come to grips with its real problem, it had to rely on its own strength. Somewhere within it there had to be found the sagacity and persuasiveness to bring about a meeting of the minds on a sound plan and the energy and political sense which would vitalize public opinion behind it.

Where could such strength be presumed to lie?

As Europe saw the Committee, it represented in its eight European members little more than a repanelling of the best brains of the Old World, which, during the long-drawn controversy, had already been freely drawn upon for counsel with-

out result. The Reparation Commission, in the four years of its occupancy of the Hotel Astoria at Paris, had not worked in an intellectual vacuum. It had availed itself of every scrap of assistance which Europe afforded, and the controversy had only grown more bitter.

Bonar Law had called the problem "almost hopeless." As a subject for concrete diplomatic negotiation and action, its inherent difficulties were made incredibly worse by the tangle of the formal record. There were not half a dozen men in Europe who could find their way through its mazes. The Reparation Commission had held 400 meetings and the Allied Premiers had met a dozen times—at Spa, San Remo, Cannes, Paris, London, and elsewhere. In the minutes of those meetings, and in the contents of a vast mass of economic, financial, and legal reports, there were literally hundreds of items of unfinished business on which it had been impossible to reach agreement. This formidable record, moreover, held as its prisoners most of the persons who had dealt with reparations in a responsible way. There were few of them who had not taken up positions from which it was extremely difficult for them to retreat.

Obviously, the chief hope for the Dawes Committee lay in the American members. But concerning the qualifications of Charles G. Dawes and Owen D. Young, Europe had scant knowledge and seemed to have only moderate curiosity. To Euro-

pean eyes, they were merely two more of a series of observers, enjoying the confidence of the government of the most powerful nation of the globe, but officially without status as its representatives and personally not presumed to be miracle makers.

Europe did not know that it had turned up in Dawes one of the most effective moulders of public opinion, and in Young one of the greatest constructive minds of the day.

CHAPTER V

THE ANGLO–FRENCH DISPUTE

DAWES and Young stepped into a highly charged situation dominated by the tension of the relations existing between the English and the French.

They were members of a body with limited powers, the feebleness of which went back to that same interracial suspicion to which the dangerous position of the whole reparation question was attributable. That suspicion, deeply rooted in past history, was nothing new in interallied relationships. To it had been due much of the ineffectiveness of the Allied conduct of the war, as well as of the peace. The cautious grant of authority in 1923 to a committee sponsored by the British had its prototype in the dubious powers intrusted to a great French soldier at a fateful moment in March, 1918, when the Germans had broken the Allied line in Picardy.

In 1918, the immediate peril had been to France, with only a secondary threat to England; and Lord Milner, the British Minister of War, at the earnest solicitation of Clemenceau that a French com-

mander in chief be appointed, gave a grudging assent. He agreed that Foch, for the purpose of "coördinating" the action of the Allied armies, should be directed to "come to an understanding" with General Haig, and that the latter should be "requested to furnish him with all necessary information." In 1923, the immediate danger in the continued paralysis of Europe was to England, while the secondary threat was to France; and Poincaré reluctantly consented to allow the Dawes Committee to "consider" the situation.

Obviously, there did not exist in France the same acuteness of interest in the useful possibilities of a committee as that which prevailed in England; nor was the trend of events, as they were shaping, viewed with the same degree of pessimism.

England, economically, is the most vulnerable of the great nations. Disturbances in any one of those numerous areas abroad, where normally there is a demand for British goods or a surplus of raw materials essential to British industry, are promptly reflected in Liverpool, Manchester, and "the City" of London. The blockade of the cotton ports of the South during the American Civil War, which deprived England's premier industry of its raw material, caused a serious depression and badly strained Anglo-American relations. A major disturbance on the continent of Europe is of grave moment to the life of England, and, if long continued, a settlement of it becomes a matter of al-

most desperate necessity. Particularly is this true of a disturbance in Germany, which is normally England's best customer.

The economic position of France is quite different from that of England. Relatively speaking, France is self-contained. To the French, holding the coal mines of the Ruhr, the collapse of Germany would be, in its economic effects, a matter of relative unimportance.

The French government, moreover, was deeply committed to the Ruhr enterprise. It had spent months in laboriously consolidating its position there, and no one in his senses believed that it could be coaxed out by vague generalities—much less by the promise of both a deep cut in the reparation debt and a complete cessation of current payments, which was all that Bonar Law and Curzon had felt able to offer.

The French had gone into the Ruhr to take pledges, put an end to the cancellation propaganda, and protect their claims. The English Liberals made the mistake of not taking the French exactly at their word on this matter. The English had two theories regarding the Ruhr, both of which missed the point and neither of which did justice to the intelligence of the French people. One assumption was that the French had given up the idea of reparations and were bent on the dismemberment of Germany. There was no evidence in the attitude of the French people of any such desire or ambition.

The French wanted peace—not an opportunity to face a new coalition of Europe such as Napoleon faced. If there existed a Frenchman of importance who felt that the French nation had either the desire or the strength to play such a rôle in Europe, his testimony was not placed in evidence.

An alternative assumption regarding the Ruhr was that the French expected large cash profits from it, and that when these failed to materialize they would quickly withdraw. This was to miss the whole purpose and significance of the occupation. The purpose of the occupation of the Ruhr was to convince England that it was to her interest to support France in an effective, peaceable programme of collecting reparations. Even the persuasion of Germany was secondary to that purpose. For, in this great post-war duel, Germany from the first played only a passive rôle.

In the matter of large direct cash benefits to be derived from the occupation, Poincaré was plainly taking his chances. They did not at first seem good. It seemed probable that they might fail to materialize before his major purpose was achieved, and in that case that he might be forced out of the Ruhr by the bankruptcy of the Treasury. But, as it happened, he was not. For in the autumn of 1923 the occupation began to pay dividends, and the first liquid payments which up to that time had been received on reparation account, over and above

the cost of holding the left bank of the Rhine, fell into the coffers of the French Treasury.[1]

The French were not enamoured of the solution of the reparation problem on which they had embarked. It was plainly a most precarious business. But there was an extraordinary unanimity of belief throughout France in its being the lesser of two evils. The alternative, in the opinion of the French people, was to struggle without relief under the weight of an overwhelming debt. They had gone into the Ruhr deliberately and they were determined to see the business through. The deadlock of four years had at last been broken. For the first time, the chief creditor was in direct contact with the debtor, and, aided by the votes of Belgium and Italy on the Reparation Commission, was in a position of control over Allied reparation policy.

Though it was not apparent to the English, the logic of facts made it certain that, within the limits of her ability, France would continue to maintain her control over the situation until persuaded that equal security for the reparation debt and equal effectiveness of aid to her treasury could be had by surrendering it.

In urging that wide powers be given to the Committee, it had been the problem of England to

[1]See "Un An d'Occupation," published by the occupation authorities at Düsseldorf, February, 1924, showing (p. 68) the receipts for the year 1923 to have been 1,329,000,000 French francs and the combined expenses of the French and Belgian occupation to have been 850,000,000 francs.

satisfy the French on those two heads. It was no academic problem that England was facing. It was a condition, not a theory, and the relief of that condition was vital to England. But English policy, usually so competent, had conspicuously failed to meet the situation.

It had failed for the same reason that France in 1918 had failed to persuade England to give *carte blanche* to Foch. Adequate consideration had not been offered for the relinquishment of powerful instruments of national security. There was no *quid pro quo*. In 1918, France had had nothing to offer. She was *in extremis*, with every ounce of strength already engaged. But in 1923, the English had had plenty which they might have offered, had it not been that a large section of English opinion was under the strange delusion that international politics has no realistic basis. France was expected to surrender her control over the reparation situation in exchange for nothing at all.

Neither in 1918 nor in 1923 did the petitioning power get what it wanted. But in each case, mindful of the extreme danger of its own position, it took what it could get and left it to the Allied nominee—France left it to Foch on the one occasion and England left it to the Committee on the other—to complete the conversion of the recalcitrant party and then to deal with the common peril.

In 1923, it was up to Dawes and Young to allay

the fears and suspicions of the French. That "agonizing and implacable paradox of defeat in victory" which burned in the French breast had to be appeased. For four years such an appeasement had been the most urgent and the worst handled task of world statesmanship. It was essential that the French be given confidence that the world was not indifferent to their claims. It was essential from every consideration of good morals and from every consideration of good sense. The French were in the saddle; and enough people believed them to be right to make it certain that threats of separate action, whether military or financial, could not be made good. Curzon had discovered that a policy of shaking the fist at France could be followed only by one of shaking the finger. The French had to be won by conciliation.

The immediate form in which this task presented itself to the American members was to gain the confidence of the French in the Committee itself. In one form or another, that same task ran through every phase of their work. The French were in a highly cautious frame of mind. For four years it had been commonly said in England that active American participation in the reparation problem would mean support for the British position and the creation of a powerful minority block of two in the Allied councils. The French were prepared to believe this.

Secretary Hughes had said that the United

States had "no desire to see Germany relieved of the responsibility for the war or of her just obligations." The French did not question this. But, after all, it was only a generality, and Hughes, in emphasizing the necessity of taking into account "the capacity of Germany to pay," had not disclosed the American attitude on the particular matter of the capital debt which the French regarded as vital.

In dealing with that point, Poincaré had said to Curzon: "It is impossible to estimate, once for all, the present and future capacity of Germany for payment. It is at present at its lowest point, and an estimate made now would only benefit Germany." But the British had consistently pressed for a "complete and final settlement." They had characterized the question of capacity to pay as a simple question of establishing a fact. The French took for granted a certain similarity in the mental processes of all English-speaking persons. They were not unprepared to encounter in the American members that exasperating attitude so common in diplomacy in which an expressed sympathy in principle is combined with a consistent opposition in practice.

The American delegates had a highly difficult course to steer. The only attitude which as peacemakers they could possibly adopt toward the French was to treat them as rational beings, possessed of a civilized sense of responsibility, and

to examine their case for possible points of agreement. In the tense state of feeling which existed between the French and the English, such a course had its serious embarrassments. The open or tacit criticism of British policy which might result raised a danger to be met on the other side. In this position of affairs, Dawes and Young had to pin their faith on the good sense of the British members of the Committee and the ability of the latter to carry British opinion with them.

In this they made no mistake. Neither Stamp nor Kindersley had any personal responsibility for British reparation policy of the past. They had taken no fixed position from which pride of opinion would prevent them from retreating, even had they been of that inflexible type of mind. They seemed to be reasonable persons with whom it would be possible to differ frankly, without endangering the common search for a solution. More than that, the British generally had been the staunch advocates of a free hand for the Committee. All Englishmen, whatever their explanation for it, freely admitted the failure of their own national policy; and few were averse to permitting new minds to wrestle with the problem in their own way.

The humiliating position in which British foreign policy found itself must have given Dawes and Young food for serious thought in connection with their first and most pressing problem of interallied conciliation. In four years' time, English prestige on

the Continent had fallen from the highest point which it had attained since Waterloo to the lowest ebb of modern times. The war had greatly enhanced England's traditional position of advantage with relation to continental affairs. France and Germany were exhausted and, with the withdrawal of the United States from participation in European affairs, the weight of England, thrown into the scales on one side or the other, was bound to be determining in the course which the reparation problem would take. With the ratification of the Peace Treaty in January, 1920, it was to England alone that the French and the Germans were able to look for the practical arbitration of a bitterly controversial question of first importance to both nations.

As a conciliator, England, in 1920, had stood in a not unfavourable relationship to both parties. English interests no longer clashed directly with those of Germany. The German threat to British trade and to the navy which protected it had vanished. The German world-trade organization had been disrupted, and the high seas fleet was at the bottom of Scapa Flow. Moreover, with the eclipse of Prussian militarism, a community of cultural interests and a certain racial compatibility had begun to have their favourable effect on Anglo-German relations. All in all, the position toward Germany was extraordinarily easy.

Nor, with France, was there any serious clash

of national interest actually in being. France and Britain both had serious things to accomplish which had in them possibilities of misunderstanding, but, on any long view, no substantial basis of conflict.

France had to work out the problem of her military security and establish a system of indemnity collection. She could accomplish these things only through England's aid. England, on the other hand, needed above all things a stabilization of the Continent for the resuscitation of her trade. Such a stabilization could come only through the restoration of France. Fundamentally, there was a vital community of interest between the two allies. But the tasks which lay ahead of France were such as would produce agitation and renewed tension on the Continent; and one of them—that relating to reparations—seemed likely, even at best, to prove in some degree disturbing to British trade. Here was the chance for misunderstanding and the possibility of disaster. For, if the English were tempted to look for short cuts back to stabilization, and if those short cuts should involve a denial or seeming denial of the claims of France, stabilization would be still longer and more dangerously deferred. For the French would not submit without a struggle.

The plain Englishman was instinctively clear on these matters. He was a person of simple ideas, and one of those ideas was loyalty. His instinct—that

propensity which science tells us to distrust—was to see France through her troubles—to see restitution made. He had no complicated theories about short cuts back to a better Europe. He suspected that he would have need of all his reserves of fortitude before that world fit for heroes, which Lloyd George was promising, could come to pass. He felt that there were hard times ahead; for they were already on him. But "dogged does it" is a major tenet of his philosophy. The plain Englishman, in short, was prepared to see the peace through properly as he had seen the war through.

Thus, in 1920, it seemed entirely reasonable to expect a continuance of favourable relations with France and to look for successful mediation by Britain between the two continental powers. No one then dreamed that the intellectually elect of the country were about to be swept off their feet by a wave of economic faddism and racial hysteria upon which the agile Lloyd George would launch a new foreign policy of incredible ineptitude, directed against the French.

The brilliant promise of a panacea was about to flash across the sky. A new philosophy was brewing in the minds of British economic thinkers which would falsify the antiquated ideas of the plain Englishman. New laws were in process of discovery which would nullify all international debits and credits and indicate Germany instead of France as the victim of the war. New and complicated defi-

nitions of national interest and international justice were being framed. The result of all this brilliant esoteric thinking was to be an easy and simple escape from the difficulties of tranquillizing an agitated world.

The result, as it actually turned out, was quite different. In less than three years' time, France, at great peril and embarrassment to herself, had gone her own road; and the Germans, in acute distress, had come to the conclusion that British policy was of no practical assistance to them. The Liberal government under Lloyd George had thrown its weight against the French. But the plain Englishman had withheld his support; and when the French invaded the Ruhr, British policy collapsed. With an anti-French government in office and a considerable pro-French sentiment abroad in the land, the English ship of state found itself unable to navigate.

British economic and financial experts had discovered two curious economic maxims to which brief reference has been made in a previous chapter. One of these maxims was that the burden of an internal debt was not a real burden in the economic sense; the other was that large international debts could not be paid.

In pursuance of the first maxim, the economists were prepared to forego, on the part of the British taxpayer, Britain's share in reparations. The taxpayer, in their view, would benefit more by cutting

losses and getting back to work than by attempting to enforce an equalization of tax burdens upon the Germans.

It was a plausible argument; and if British tax burdens had not been so unconscionably heavy, it would have had much force. In any event, if that had been all of it, it would have been a purely domestic matter for decision by the British taxpayer. But it involved something more. It involved the application of the same doctrine to the French claims on Germany. These, too, the British economists were prepared to forego. But the French were old-fashioned on things economic. They were under no illusions as to the reality of the burdens entailed by a heavy public debt—a state of mind, be it noted, to which, with the present decline of economic faddism in England, British opinion is now generally converted.

Maxim number two introduced the idea that a debtor country could settle its foreign obligations only through an export surplus. As debtor countries obviously have no export surpluses, the conclusion was that large international debts could not be paid. There was, however, an alternative condition to be considered. If the creditor should decide to wait until the debtor produced an export surplus, and then collect his debt, in that event, he would be seriously embarrassed, if not ruined, by a flood of foreign imports taken in payment. The creditor, so the theory went, would face a dumping menace

of a new and exaggerated type. The conclusion was that cancellation of the British claims on Germany was highly desirable.

Up to that point, the second maxim concerned only Britain, and it was for the British taxpayer to come to his own conclusions regarding the prospect of being ruined by being paid. But, like the first maxim, this one also had to be extended to France. For the economists maintained that, if the French claims on Germany stood, the effort of Germany to develop an export surplus with which to pay would rebuild Germany's industrial strength and re-establish her as a competitor of England on the world market. More than that, it was said that the deliveries in kind to the continental Allies in payment of reparations would cut into English sales in those countries, while the dedication of a considerable portion of the earnings of the German taxpayer to reparations would reduce the sales of English consumption goods in Germany.

These considerations also had some superficial plausibility. In reality, they amounted to little or nothing. For, firstly, whether or not Germany paid the reparation debt, German industry was bound to revive; and secondly, if reparation deliveries were made by the German taxpayer in relief of the French taxpayer, the decrease of the spending power of the former for English consumption goods would be to a large extent offset by the increase in the spending power of the latter.

Whatever measure of truth there may have been in the doctrines which stressed the advantages to England of immediate repudiation of the reparation debt, those theories failed to take into account one determining consideration on the other side. That consideration was practical psychology —the greatest and most potent economic factor of them all.

The reaping of the problematical advantages which England was to derive from cancellation of the reparation debt depended entirely on the man in the devastated area in northern France. The battle would be half won, if that simple-minded person could be persuaded that his debt burden, larger than that of the German burden, was "in the economic sense" no burden at all, because it represented an internal debt while the German burden represented an external debt. The battle would be wholly won if it could be further explained to the French peasant that the uncertainties of the export surplus would prevent Germany from paying him or, if not, that the payment would ruin him.

English economists and financial authorities staked the recovery of their country and the maintenance of its prestige in Europe on the chance that the peasant voter of northern France would accept these doctrines. It was Poincaré, as Premier of France, who was expected to expound these new ideas and make sufficient converts among the

voters to swing French policy to immediate cancellation of 60 per cent. of the reparation debt. For his failure to do this and for his own disbelief in the new economics, he was savagely attacked in England on grounds reflecting on his intelligence, his courage, and his sense of fair play. Truly, the hard-headed British people had been delivered into the hands of dangerous political amateurs.

These ideas seem to have sprung from the brain of Professor J. M. Keynes, the British economist who in 1920 took England and a large part of the civilized world by storm with a satirical sketch of the Peace Conference, appearing in the early pages of his famous book *The Economic Consequences of the Peace*. It was a trenchant word picture, and it carried its readers along to an enthusiastic acceptance of the politico-economic tract to which it served as an introduction.

In this and a companion volume, Keynes preached a new scrap-of-paper philosophy—the scrapping of the Treaty and the reparation debt. It fell on ears outraged by the cries for retribution on Germany uttered by the Lloyd George cabinet in its post-war reëlection campaign. Keynes did a service in rallying opinion against the cry for vengeance. But his counterplea swung the pendulum far in the opposite direction. More skilfully done than Lloyd George's philippics, it was in fact scarcely less ill-considered.

The three considerations of England's interest, the economic law, and the moral law were blended into an effective rhetorical whole, picturesquely sprinkled with epithets and properly interlarded with statistics, a large part of which, as it happened, were either hypothetical, defective, or grossly inaccurate. Based on the alleged economic spoliation of Germany by the Treaty, Keynes popularized the picture of a "Carthaginian peace." Based on errors in his exchange calculations, he started the canard of fraud in the French reparation claim,[1] and based on his unsupported statement, accepted as that of an economist, he disseminated the legend that the French were "notorious" tax dodgers.

To anyone who did not live close to the problem through the months which followed, the virulence with which this body of doctrine took hold of the English governing classes would be almost unbelievable. The economists were stampeded, and along with them politicians, civil servants, and leaders of industry and finance. Plenty of plain Englishmen, mostly Conservatives, kept their heads. But they could not stem the tide.

The new economic theories fairly obsessed the minds of the intelligentsia. An epidemic of intel-

[1]See "Reparations and the Policy of Repudiation," by Alpha (George P. Auld), *Foreign Affairs* (N. Y.), September, 1923; also Keynes-Alpha and Keynes-Auld correspondence in London *Times*, September 15 and September 22, 1923; *Economic Review* (London) October 12, November 30, 1923, January 4, January 11, 1924, and the *New Republic* (N. Y.), January 23, February 20, and April 2, 1924.

lectual snobbism swept the country. Those who did not share in the new revealed wisdom were treated with pitying contempt. Not to be numbered among the instructed few who related the whole reparation problem to Germany's export surplus was to be a person of no consequence whatever.

The Conservatives, as their name implies, were for going slow. They distrusted the new doctrines. Where they would lead, they did not know. The idea that an internal debt was not a burden in the economic sense was entirely beyond them. The assumptions that Germany had to pay through an export surplus and that she could not produce one were new conceptions which they were not prepared definitely either to affirm or deny. But assuming that the first one was correct, the second one seemed to presuppose an extraordinary lack of elasticity in the operation of economic forces, considering the fact that such forces result from the acts of animate beings. If the Germans had the will to pay, they asked, what was to prevent the production of this surplus?

The Conservatives felt that it was folly to insist on an immediate final settlement of the reparation problem on the basis of untested theories. The emphasis placed on the mechanics of the problem seemed to them wrong. They had a deep conviction that, as an international problem, the question was one of equity. As a social and economic question, they believed its solution to depend on a slow

recovery which could not be forced. And, finally, the Conservatives preserved a certain realistic attitude toward foreign affairs. Was it wise, they asked, to attempt to upset the Treaty of Versailles, which, whatever its defects, was the only charter which the new Europe possessed?

All of these things they urged. But their thinking was not well organized. Nor, in truth, on the subject of the export surplus, now better known as "the transfer problem," was anyone's thinking well organized. In its newly acquired significance, no one had ever given the subject any thoroughgoing study. That debtor countries settle their international balances by refunding seemed to occur to no one. Evidently, it was a time to go slow, to hesitate to accept a thesis which asserted that principles of equity must bow to newly discovered laws of commercial mechanics.

The argument from equity was the strongest argument the Conservatives had. The economists met it by ridiculing it as rank sentimentalism and then by invoking counter equities of their own. Germany, they said, had suffered more serious injury than France. They urged the crippling effects due to the loss of mineral areas in Lorraine and Silesia, omitting, however, to dwell upon the tendency of raw materials to move to suitable markets despite frontiers, or to point out that Germany no longer had to support the populations of

the alienated territories. Other reasons, discreditable to the French, such as we have already reviewed, were adduced for regarding the collection of a large reparation debt as morally indefensible. The underlying facts had not been sifted. The average man was unable to sift them, and in many cases he had no disposition to do so, for pro-French sentiment had begun to decline.

The consciousness of similarity of political ideals with France had lost much of its force as the republic in Germany had become more firmly established. The sympathy felt by reason of the ruin of northern France had diminished with the disappearance of the obvious evidences of damage, the more rapidly from the persistence of unemployment in "the English devastated area." There remained the good will induced by the charm of things French in the minds of thousands of travelled Englishmen. But this had its opposite and equal force in the minds of those numerous Englishmen who shrink from sentiment in themselves as intellectually debilitating and who regard other races of highly developed æsthetic gifts as morally suspect.

Where it existed, this incompatibility of racial temper found it easy to believe that the difficulties of the French were due to every cause but the real and obvious one of an unparalleled wastage by war. The legend that the French were not paying

heavy taxes was taken as gospel. The baseless story of a fraudulent reparation claim was accepted as a fact. The fact that, except for the absolute wiping out of the deferred portion of Germany's debt, the French had consistently met all of England's demands for the lightening of Germany's load, was ignored.

A case had been made by the economists for the idea of a short cut back to the stabilization of Europe. All the nuisance of international debt collecting was to be avoided.

In August, 1922, the Balfour note, addressed to the European allied governments, declared that cancellation of all international war debts was to be England's governing policy of reconstruction. The whole weight of this pronouncement fell on reparations, for England, finding the chief creditor on interally debt account unresponsive, concluded a few weeks later a definite funding agreement relating to her debt to the United States. This action did not stem the movement for cancellation of the reparation debt. Rather, it accentuated it. Baldwin, as Chancellor of the Exchequer under Bonar Law, had concluded the debt-funding agreement in defiance of the cancellationists. The latter saw clearly enough that an open attack on the American settlement would have an adverse effect on British credit. In consequence the whole force of their deeply held convictions on international debts was vented against the reparation debt.

The French saw the ancient doctrine of repudiation, dressed up in a new scientific garb, suddenly become respectable and intellectually fashionable. Speaking of the payment of reparations on a large scale over a period of one or two generations, Keynes, in 1922, said: "There is not the faintest possibility of our persisting with this affair to the end."[1] It was clear from the tone and context that he spoke primarily not as a forecaster of future events, but as an advocate of policy. The French had noted the rise of Keynes to a position of great prestige in England; and the Bonar Law-Bradbury note of January, 1923, appeared to them definitely to confirm his views as representative of the attitude of the British government and people.

Two figures dominated British reparation history of that period—Keynes and Sir John (now Lord) Bradbury, the British delegate on the Reparation Commission. Keynes was the prophet—the exhorter in private life. Bradbury was the political and diplomatic instrument. He translated the Keynes doctrines into policy.

During the war, Keynes had been attached to the British Treasury and in 1919 had been a member of the Treasury delegation at the Peace Conference, from which he had resigned as a protest against the obligations laid upon Germany in the Treaty. Bradbury was a high official of the British civil service and before coming to Paris had been perma-

[1] *A Revision of the Treaty*, English edition, page 158.

nent joint Secretary of the Treasury. His name had become a household word in England, by reason of his signature on the pound notes which during the war took the place of the gold sovereign and were colloquially known as "Bradburys." It became a household word in France in a different connection.

From the time of the organization of the Reparation Commission in the autumn of 1919, Bradbury was the one important official of the government who dealt continuously and exclusively with the reparation question. Before Lloyd George left office in the autumn of 1922 Bradbury's position had become equivalent to that of a minister for reparations, without, however, any responsibility to Parliament. Lloyd George, after his conversion to the new doctrines, was a complacent chief, and Bonar Law, who succeeded him, was a sick and helpless one, who, though well disposed toward the French, fell heir to a first-class crisis upon which he had no one but Bradbury to rely for advice.

It was common knowledge that the Bonar Law note which preceded the occupation of the Ruhr was the work of Bradbury and his staff. The ultimatum regarding the cancellation of the C bonds which it embodied represented the, by then, sacrosanct doctrine of the export surplus, translated for the first time into definite political action. The extraordinary tone adopted by the British members of the crucial conference at which the note was

presented may be gathered from the following extract from one of the British documents:

"To treat the existing C bonds as having real value is notoriously contrary to facts. . . . The C bonds can only be regarded as a bad debt which must be written off. The writing off of C bonds is imposed by the realities of the situation. Until this is done, German credit cannot be established, and the value of A and B bonds suffers accordingly. Again, what are the facts? The proposal from the British government is to exact from Germany the maximum which it is thought she can pay. It is useless to complain if larger sums cannot be obtained."

Can one imagine such a note being addressed to the government of the United States of America?

Bradbury consistently underrated the intelligence of the French. He suffered from a fatal inability to deal with them without arrogance. Throughout his five years at Paris he habitually presented the British point of view brilliantly and coherently, but at crucial moments a sting in the presentation robbed it of persuasiveness. He was a man of great intellectual force and cultivation, of perfect rectitude and the kindest and most charitable instincts in private life; but a bureaucratic training, a racial incompatibility with the French, and a highly developed and freely indulged gift for caustic epigram gravely detracted from his usefulness in a supremely important diplomatic post.

The chief amplifier of British reparation policy to the public was the *Manchester Guardian*, the powerful organ of Liberalism.

The modern Liberalism was not the Liberalism which two generations before had emerged in Manchester as a result of the industrial revolution. The new Liberalism had succeeded to its name and prestige but not to the spirit of its founders. Cobden and Bright had fervently believed in the efficacy of trade, of free and unrestricted trade, as a healing influence in the affairs of mankind in the broad. Trade was to make for international peace. The modern Liberals had the same belief, but they were lesser men than Cobden, and their philosophy had a distinctly nationalistic tinge. It was not trade generally but British trade particularly which they saw as the chosen instrument of world salvation. Thus, in the passage of time, all the moral sanctions which underlay Cobden's enlightened philosophy had been brought powerfully to the support of a nationalistic theme. Liberalism had become the party of British business.

On the other hand, it was also still the party of the intelligentsia. In this wing were to be found the successors of all those eager young men of the universities who had enrolled under Cobden's banner because of their interest in his programme of domestic reform.

The connecting link between these dissimilar wings of the new Liberalism, between the university group

with its idealistic and cultural tradition and the business group with its fervent attachment to British trade, was the school of the new economics. This school of university thinkers had provided the art of business with the background of a science, partly genuine and partly spurious. It had established itself as the professional advisor of British business. The young men who comprised it were masters of the patter of Liberalism, they were not unworthy exponents of its cultural attainments, and they looked on trade as an ethical end in itself.

The *Manchester Guardian*, published in the heart of the manufacturing region, is the mouthpiece of this school. French policy interfered with British trade, and the new economics was properly indignant. It was shocked by the turpitude of the French, and, as a result, Manchester became the seat of a furious anti-French agitation based on high moral grounds.[1]

If it had been the victims of unemployment themselves who had precipitated this outburst of Francophobia, it would have been understandable. But it was not. The plain man, distraught and bewildered though he was, kept his head. The agitation was carried on by those styled the best minds of England. On the part of minds with claims to

[1]History was repeating itself. Cobden himself, in 1862, published a pamphlet entitled *The Three Panics*, the object of which, as stated by his biographer in the *Encyclopædia Britannica*, "was to trace the history and expose the folly of those periodical visitations of alarm as to French designs with which England had been afflicted for the preceding fifteen or sixteen years."

such a rating, the raising of this hue and cry against the French was an act singularly out of character. Normally, the best minds are accustomed to handle a moral issue with exceeding circumspection. For, like a hand grenade, it sometimes explodes before it gets clear of the home trench.

The policy of the Liberals was a tragic blunder. An affirmative foreign policy in a crisis can face in only one of two directions—toward conciliation or toward force. While Liberal policy was avowedly directed toward conciliation, in reality it faced toward force. Its purpose was a moderation of French demands on Germany. While the premise that the French demands were actively and definitely excessive was ill founded, the object was, in the broad, a respectable one, for moderation is always respectable.

With their eyes fixed on such an object, the Liberals deceived themselves into believing that their influence on the affairs of a seething world was a moderating one. It was not so in fact because it was exerted, not with moderation, but with violence.

Those who expect to pacify by diatribe must be prepared to carry their violence through to the *ultima ratio* of force. This the Liberals could not or would not do. But force was the result, none the less—the force exerted by the French when Liberal policy played its great part in driving them into the

Ruhr. The reason for the collapse of the policy of the British intelligentsia was not solely that their facts were wrong; it was the utter lack of reserve with which their new facts or supposed facts were seized upon and cut or stretched to prove that everything which for four years of war had been white had suddenly turned black.

The British intellectuals laid upon France in unsparing terms the responsibility for the chaos of Europe and the prostration of British industry and trade. The "moral isolation" of this international Shylock was called for by men whose positions assured an attentive audience. In the presence of an admittedly explosive state of public feeling at home resulting from unemployment, the inflammatory doctrine of a foreign scapegoat for domestic troubles was widely disseminated. The cry was echoed throughout the whole trade group, in Manchester, in Liverpool, and "the City." The wonder is that any other result should have been expected than that which came.

Why should intelligent persons have thought that Germany would regard the reparation debt with greater favour than the British? Why should they have believed that the German default on deliveries in kind in 1922 had no connection with the British campaign for repudiation of the debt? It is strange that Liberal policy should have been expected to keep the French out of the Ruhr or get them out once they were in. It is strange that

a display of undisguised contempt should have been thought a suitable form of state craft with which to induce an amicable settlement with a great people, conscious of their claims to the respect of mankind.

Providentially, Liberal policy was never convincing to large inarticulate sections of British opinion. Had its authors' claims of unanimous public support been accurate, the government would have been driven irresistibly into the last phase of a policy in which every precept of diplomacy had been ignored. Before such a catastrophe could happen, the British people rejected the diagnosis of the economists and turned to other counsellors for guidance in their foreign relations.

It is an old and tried principle that experts of the science of war must be subordinated in the formulation of national policy to the civil power. The British were beginning to perceive that the experts of the science of economics must equally be brought under the firm control of statesmanship. The drive to abolish the rôle of the statesman in world affairs was almost spent. The pretensions of the new science were due to be curbed. The ideas that the reparation question was a purely economic problem and that economic problems are susceptible only of exact scientific solutions were about to receive a serious setback.

When Dawes and Young arrived in Paris, there were unquestionably both in England and France

strong undercurrents of opinion which made the prospects of conciliation less gloomy than they had been six months before. But the movement toward the disintegration of Europe had gathered great momentum. It seemed to be definite and rapid, more so, in the judgment of many, than the movement toward the formulation of a united opinion capable of checking it. It appeared to some that only a striking appeal would serve the purpose of the moment.

To frame such an appeal, no one could have been better suited than General Dawes. As an indispensable qualification he had a record of successful public service. As chairman of the Purchasing Board of the American Expeditionary Force, and as organizer and director of the first budget of the United States, his vigorous personality, his ability, and his high sense of duty had become familiar to the American people and in some degree to Europeans. Dawes is a man of great courage, healthy-minded and direct, and he possesses that indefinable power of arresting public attention, for the lack of which in their leaders many good causes come to nothing. Dawes was convinced that a new note must be sounded which could be heard outside the Committee room. At the first meeting of the Committee, which was held on January 14, 1924, jointly with the Reparation Commission, he struck that note. In blunt and homely phrases he uttered some of the things which men everywhere

were thinking. It was, in his opinion, "no time to mince words."

The first requirement of a situation in which delays were dangerous was to reassure the French. In reviewing at the outset of his remarks the common effort and sacrifices of the war, Dawes performed that service, and when, a month later, he was widely quoted as saying "if France were not in the Ruhr we would not be here," it became certain that the French people would at least listen to the Committee.

Warming up to his subject, General Dawes, in the body of his opening address, called upon the Committee to sweep aside the "impenetrable and colossal fog bank of economic opinions . . . and legal arguments . . . laboriously compiled [while] the foundations of economic Germany have well-nigh crumbled." The success of the Committee, he declared, depended "chiefly upon whether, in the public mind and conscience of the Allies and of the world, there is adequate conception of the great disaster which faces each ally and Europe, unless common sense is crowned king."

The address of the chairman exploded in the Committee room and in the press with a stunning effect. In substance, it was distinctly unpalatable to many, and it was shocking to orthodox ideas of diplomatic procedure. But it served its purpose. Evidence of its favourable reception throughout Europe and the United States appeared from the

comments of journals of every shade of opinion. The French were frankly delighted with it. The British—particularly expert and official opinion—greeted it with considerably less enthusiasm, but on the whole very well. This "somewhat flamboyant address," said the *Economist*, the most substantial and moderate of the English economic journals, "was not devoid of fundamentals." The Germans, perhaps at last clear that the Allied solidarity for which Dawes pleaded was their only salvation, seemed to find nothing greatly disturbing about the General's sentiments.

All in all, this opening address everywhere touched a responsive note in the public mind throughout the world. It had its great influence in healing the breach between the Allies and in turning the tide of events in Europe.

CHAPTER VI

STABILIZING THE MARK

AFTER the first formal meeting with the Reparation Commission, the Committee went promptly to work. It divided itself into two subcommittees, one on the Currency, headed by Mr. Young, and one on the Budget, headed by Sir Josiah Stamp. The two met separately almost daily during the three months' period of the Committee's existence; and the full Committee, under the chairmanship of General Dawes, met on an average of four times a week. The labours of its members were prodigious. All their waking hours were given over to consideration of their problem.

The first task, in the words of General Dawes, was "to devise a system for stabilizing Germany's currency, so that we can get some water to run through the budget mill."

The mark, originally worth 4.2 to the dollar, had gradually declined during and after the war to a value of 200 to the dollar at the beginning of 1922. During the next twelve months it had travelled rapidly downward until, at the end of 1922, it had stood at 7,000 to the dollar. In 1923, it had plunged

into an abyss in which its value was expressed in ratios of millions, billions, and finally trillions to the dollar. It was no longer a currency in anything but name. It had practically ceased to be a medium of exchange, emergency currencies having largely superseded it; it no longer served as a standard of value, prices being quoted in gold; and it was unsuitable as a means of saving, since by its constant fall it served only to dissipate the values held by its owners.

The year 1922 had been the significant year of the fall of the mark. Before 1922, it had experienced only a gradual sag, due to the fact that moderate deficits in the budget had been met by the printing of paper currency. During that period, its value had gradually declined from 3.2 cents in the last months of 1919 to an average of 1.7 cents in 1920 and 1.2 cents in 1921. After 1922, the ruin of the mark had been inevitable, not only because of the large deficits involved by the financing of passive resistance by the government, but also because the forces of inflation in its advanced stage have a cumulative effect and until the bottom is reached are self-perpetuating.

It was the drop in 1922 which precipitated the reparation crisis, for the Allies saw their claims vanishing into thin air. The chief cause of that drop was the excessive sale of marks in exchange for foreign currencies. The offerings of marks by those holding them who wished to ac-

quire dollars, guilders, and sterling exceeded the normal demand for marks by owners of foreign currencies who wished to pay for German goods. Germany had become a debtor country, but the new creditor continent had not yet started lending dollars to her. In consequence, Germans desiring foreign moneys had no means of getting them except by auctioning off their bank deposits to the highest bidder abroad—an utterly unnatural and ruinous process. There were, however, plenty of foreigners who were attracted by the apparent bargain. More than a million such, according to the estimates of the McKenna Committee, bought marks as a speculation, with the result of placing in the hands of Germans large reserves of foreign moneys abroad.[1]

What caused these forced sales of marks in 1922? Why were the Germans so persistently in the market for the purchase of foreign exchange? Around the answers to these questions raged one of the acute controversies of reparations. The Germans maintained that the excessive sales were due to the necessity under which their government was placed of buying foreign currencies with which to meet the schedule of reparation payments. The French believed the sales to have been due to the determination of the Germans to place their assets

---

[1]These reserves, including also all other forms of German holdings abroad, were estimated by the McKenna Committee at a sum amounting, at the beginning of 1924, to about 1.7 billion dollars.

abroad beyond the reach of the Reparation Commission.

The French were right, but the Germans were not entirely wrong. If there had been no "flight from the mark" the reparation payments would have occasioned no great difficulty. The payments then being made were no larger than the schedule subsequently adopted by the Dawes Committee. But with international relations in a high state of tension, the reparation system could not function. International economic processes were not working normally; in particular, Germany had not yet become the object of the international lending operations necessary to the functioning of a natural debtor country in the world system. Such operations were impossible, for the currency was being catapulted downward by the pressure of a psychology of panic in Germany itself.

The dispute between France and England, more dangerous to Germany than to either of the principals, was coming to a head. France, the military master of the Continent, was pictured to the German mind as obsessed with the idea of revenge. The picture was the more convincing since it was drawn by allies of France themselves. In such circumstances, it was inevitable that recognition of a national obligation should be erased from the minds of the Germans. They could not well be blamed for it. Individuals sought to protect themselves and their families from ruin by placing their

savings in safety. They did so in increasing numbers, and soon all the familiar phenomena of a bear market on a stock exchange were apparent on the foreign exchange markets. Selling orders by holders of marks poured in, and speculators the world over, stepping in to reap a harvest from the bankruptcy, sold vast quantities of marks short. When the downward plunge became pronounced, nothing could stop it.

Internally, the forces of an advanced inflation, once let loose, worked in harmony with the forces which were depressing the value of the mark on the external exchanges. More money had to be printed, and with the increase in supply, the internal value dropped. Consumers spent feverishly in order not to be caught overnight with a supply of depreciating money. To save was impossible. Real values were in demand—fixed property and consumption goods. Demand exceeded supply and prices soared. Industry was stimulated to feverish activity. The costs of government mounted, but with the falling currency, taxes, however high when assessed, had a negligible value when collected. Sound, considered fiscal legislation was impossible while the débâcle was on. The Treasury had no option but to borrow from the Reichsbank, and the latter had no resources except its printing presses.

So it went on—more paper currency, higher prices; more money again, and still higher prices. The government was measurably helpless. Large

sections of the population were impoverished by the virtual extinction of debts, and the collection of heavy taxes on a broad basis became socially impossible. On the other hand, shareholders in industry were enriched by the wiping out of corporate debt and by the rapid turnover of their capital. But the rapidly multiplied profits of industry were put into real values. They were tied up in plant improvements or left abroad in foreign currencies, as procured through the export of manufactured goods. In either case, they were not readily taxable. The disease of inflation had to run its course before anything could be done.

In the autumn of 1923 there came a lull—a lull of exhaustion. Depreciation had gone so far that the mark ceased to have the characteristics of a currency. It had become utterly inacceptable to the public. The physical inconvenience alone of its use, owing to the bulkiness of the packages of notes required for payments, and the difficulty of calculating prices and accounts became almost unbearable. There was, besides, a shortage of money arising from the impossibility of printing it fast enough. To meet the situation, a heterogeneous collection of emergency notes, mostly unsecured, had been issued by banks and business houses generally, and about $300,000,000 in foreign currencies was also in circulation.

Something had to be done, and it had to be done by the Germans, for the project of an international

committee had not yet been agreed upon. The value of the currency had to be maintained internally by stopping the issue of notes for the payment of government expenses and externally by supporting the price on the foreign exchange markets. It was a Herculean task.

Internally, the elements of public income and expenditure had to be so adjusted as to render the Treasury independent of the printing press. Several measures were adopted. The government decreased its outgo by abandoning its attempt to finance passive resistance in the Ruhr, and shutting down on all reparation payments, which from the first of the year had been discontinued in the case of France and Belgium. The basis of its income was made more secure by placing taxes on a gold basis, and finally, on November 15th, a new currency, the rentenmark, was issued under a scheme which would provide the government with funds to tide over the critical period before income and expenditure could be effectively balanced.

The rentenmark had an arbitrary value equivalent to the old gold mark, i.e., 4.2 to the dollar. It had no gold backing, but it was secured by a blanket mortgage of 4 per cent. on all property in the country, including agriculture, commerce, and industry. This mortgage, amounting to the equivalent of $800,000,000, constituted the capital of a new bank of issue, the Rentenbank, which

emitted against the mortgage an equivalent amount of the new notes.

Of the note issue thus secured by mortgage, $300,000,000 was available for the needs of industry, $200,000,000 was set aside as a reserve, and $300,000,000 was loaned to the Reich to support the budget until April and provide for the retirement of the indebtedness of the government to the Reichsbank. That indebtedness at November 15th, after which date no further advances were made, amounted to 191 billion billion (eighteen zeros) paper marks. It was paid off by an amount of rentenmarks which was equivalent to $50,000,000, leaving the government $250,000,000 for budgetary purposes.

By the establishment of the rentenmark, the external problem was, to an extent, separated from the internal problem. The rentenmark was not legal tender, and in consequence it was not quoted on the foreign exchange markets. In all foreign operations, it was still the paper mark which was dealt in. How to support it was the problem of Dr. Hjalmar Schacht, who had been elected president of the Reichsbank two days before the creation of the Rentenbank.

At that date, the old mark was worth on the Berlin exchange about 600 billion to the dollar, but it was quoted at a considerably cheaper price on the exchange markets in financial centres abroad.

Schacht regarded it as unwise for the Reichsbank to use its remaining foreign currency reserves in an attempt to stabilize the mark at the higher value. Moreover, at the rate of 600 billion to the dollar, the entire rentenmark loan of $300,000,000 to the government would have been necessary for the discharge of its old paper mark indebtedness to the Reichsbank, leaving none of the new loan in the Treasury for the support of the budget.

During the first six days of Schacht's administration, therefore, the mark was sold down on the Berlin exchange market to a price of about 4.2 trillion to the dollar or 1 trillion to the rentenmark.[1] At that point, Schacht determined to stabilize it by offering foreign exchange at that rate and by a drastic curtailment of loans of marks to industry. By such a curtailment of credit, he made it impossible that large quantities of marks should anywhere be available to be dumped on the exchange market. Industry, deprived of marks, but under the necessity of procuring money for its pay roll and material requirements, was forced to sell a portion of its foreign currency reserves. Thus, by operation of the law of supply and demand, the value of the mark was supported on the foreign exchanges. Demand for marks exceeded the supply.

When the Committee met, the Germans for two

[1]In his recent book on the stabilization of the mark, Dr. Schacht describes the necessity which confronted him of raising the dollar rate on the Berlin market—*Die Stabilisierung der Mark*, Deutsche Verlags-Anstalt Stuttgart, Berlin and Leipsic, 1927, Chap. IV.

months had kept the paper mark at a level on the exchanges of about four trillion to the dollar. The internal currency—the rentenmark—had miraculously preserved a stable value, equivalent to that of the old gold mark, i.e., equal to about one trillion paper marks. Having a non-liquid cover, the rentenmark was practically inconvertible. A rentenmark note could neither be exchanged for gold, nor, obviously, as a practical matter, for a fraction of the real property upon which it represented a claim. But confidence in it somehow or other had been maintained. It was accepted by the government for taxes and generally by the public as a medium of exchange.

The benefits of this state of currency equilibrium and of the new tax programme were being felt, and the Treasury of the Reich was beginning to realize a budgetary surplus. In short, the state of utter fiscal chaos of three months before had been succeeded by a condition which, in the words of the Dawes Committee, was one of "temporary equilibrium."[1]

This temporary equilibrium had been brought about by the courageous and energetic labours of Dr. Schacht and Finance Minister Luther. It was a favouring factor of the greatest importance in the situation with which the Committee was con-

---

[1]To the French, this recovery seemed to furnish proof of their contention that the bankruptcy of Germany had been a voluntary one. It follows, however, from our previous discussion, that such an idea must be accepted with considerable reserve.

fronted, and it contributed enormously to the successful issue of its labours. The Committee's problem, that of merging the temporary equilibrium of that period into a permanent one, was, nevertheless, a problem of great complexity, as well as of great urgency.

In the opinion of Dr. Schacht and most other competent observers the currency situation was extremely precarious. Public confidence in the rentenmark might collapse at any moment. And the maintenance of the paper mark by a policy of rationing credit and thus forcing German holdings of foreign currencies on to the exchange market was only a makeshift. Regulation of this kind was a form of coercion, and coercion has always in the long run proved notoriously ineffective in matters connected with the movement and utilization of capital. Moreover, unless additional foreign money reserves could be obtained through foreign loans, the backing of any currency issue adequate to the needs of industry would be insufficient. The volume of business done in Germany before the war had been such as to require a currency issue (including gold coin) amounting to the equivalent of one and a half billion dollars. The rentenmark issue was, at a maximum, only about half that figure. But it could not be increased without danger of a fresh catastrophe. A complete reorganization of the currency was essential.

The broad outlines of the Committee's plan for

bringing order and permanent stability into the German currency system took shape very rapidly—in a matter of days, in fact. It provided for a new bank of issue, with a capital which was finally fixed at $75,000,000. The bank was to be a reorganization of the Reichsbank, about a third of its capital to be the assets of the latter and the remainder to be new capital. Behind its note issue, it was to have adequate reserves, consisting of gold and gold equivalent. The nucleus of such a reserve was to be provided by a foreign loan, the amount of which was ultimately set at about $200,000,000. Finally, as an essential feature, the bank was to be subject to some effective system of foreign control.

This project, measured in terms of the capital and reserves to be provided, was not of startling magnitude as modern enterprises go. Even by such standards, however, it was a major financial undertaking, and having in mind the chaos in which Europe at the time was plunged, it was a conception of almost staggering proportions. It not only involved the erection of a technical framework satisfactory to widely differing ideas of banking and currency practice; it presupposed, which was infinitely more difficult and important, the creation of an international background of credit which at the moment was utterly lacking.

These requirements brought the Committee immediately to hand grips with the broadest questions

of international policy—questions touching the prestige, the predilections, and the prejudices of the principal nations of the globe. These questions the Committee certainly could not definitely and finally resolve. That could only be accomplished by public opinion, expressing itself through political channels. But, no less certainly, the Committee had to formulate answers which in their judgment would deserve and could receive the ratification of public opinion in their respective countries. If the Committee, besides being technicians and business men, did not possess a high quality of statesmanship, capable of giving public opinion something definite to take hold of, these questions of high policy were capable of reducing their plan to so much waste paper.

Almost at the outset, a critical situation arose—one of a succession of crises which, up to the last days of the Committee's life, threatened to stamp its mission with futility and failure. The Committee found itself confronted with an accomplished fact, or practically accomplished fact, in the form of a bank project of German origin. Dr. Schacht, who was a man of great self-reliance and enormous energy, had gone ahead with a plan of his own for the immediate creation, under German auspices, of a new bank of issue. This bank—the Gold Discount Bank—was to have a capital of £10,000,000 (something less than $50,000,000), half to be subscribed by German banking houses

and half by the Reichsbank, which was to borrow £5,000,000 from the Bank of England for the purpose.

As an instrument for the permanent rehabilitation of the currency system, Schacht's bank scheme was inadequate, and it seemed likely, if it went forward to maturity on independent lines, to prejudice the prospects of the broader and more thoroughgoing reorganization which the Committee had in mind. Moreover, lacking foreign control, the scheme appeared to the Allies to be without an essential safeguard against the debauching of the German currency for the purpose of meeting budgetary deficits—something which the Reparation Commission in the past had vainly tried to prevent.

On the other hand, Schacht's project was already well advanced. It had already taken on a public character in Germany, and the interest and pride of the Germans in putting it through were already engaged. It had been considered by the Reichstag, and any attempt by the Committee to suppress it in its entirety would be fraught with the danger of arousing widespread hostility in Germany to the Committee's work. Obviously, this would be fatal to any scheme for bringing foreign capital into Germany, and would make the failure of the Committee's plan certain. Thus, within less than a week after its first meeting, this acute dilemma made it clear how difficult was to be the task of a

mission which depended for its success on a spirit of universal good will and confidence.

The dilemma regarding the proposed German bank produced an internal crisis in the Committee which was prolonged for three weeks. Rumours of it reached the outside world and made the situation even more tense. The gradual evolution of a united policy of accommodation toward the German plan appears from a series of guarded communiqués which were published by the Committee, commencing after the first meeting with Dr. Schacht on January 21st and ending on February 10th. It was thus early in the Committee's experience that the calibre of Owen Young became apparent to his colleagues and to informed persons throughout Europe.

In a book by Rufus C. Dawes, brother of General Dawes, the leading part played by Mr. Young in the unsnarling of this first hard knot has been indicated.

Mr. Young told his colleagues, so Mr. Dawes informs us,[1] "that he did not think that the Committee could assume the responsibility of preventing Dr. Schacht from putting his plan into execution. He fully understood that, if Dr. Schacht succeeded, he might create conditions in Germany which would render more difficult the acceptance of the final plan of the Committee. But he did not

[1] *The Dawes Plan in the Making*, Rufus C. Dawes. The Bobbs-Merrill Co., Indianapolis, 1925, p. 206.

wish to have the Committee find itself in the position of having prevented the Germans from utilizing their resources for maintaining an economic position achieved with such difficulty and held so precariously; because such a failure might result in precipitating the fall of the rentenmark, and by thus hampering the movements of food stuffs and raw materials, lead to chaos in Germany."

Mr. Young's chief concern, we are told, "was not whether Dr. Schacht's plan would necessarily avoid such a calamity. He wished to prevent the Committee from assuming the responsibility of putting obstacles in the way of Dr. Schacht's plan. He thought it preferable to let Dr. Schacht put his plan into operation but to make an arrangement with him whereby his bank might be absorbed by the bank proposed by the Committee in case the Reparation Commission should accept and carry out the recommendation of the Committee."

It was in the manner suggested by this tolerant and far-seeing American that this acute difficulty, like others which were to follow, was finally surmounted—by a policy of wise compromise, involving no sacrifice of principle, but insuring harmonious and effective action. In agreement with Dr. Schacht, it was publicly announced that the Gold Discount Bank which he sponsored would be so organized "as to facilitate its absorption by the bank of issue which will be proposed by the Com-

mittee." The president of the Reichsbank was quoted in the press as stating that the Discount Bank would not operate as a bank of issue but only as an agency for granting credits in connection with foreign trade.

In acceding to the settlement, Dr. Schacht definitely took up a conciliatory and constructive attitude toward the plan. In view of the man's natural force and his prestige in his own country, this attitude was of great assistance to the Committee at the time and to the Allied officials engaged in administering the plan in its early days. It is not so certain from his more recent utterances that the plan continues to commend itself to the head of the Reichsbank.[1]

Dr. Schacht's Discount Bank commenced functioning under authority of a law dated March 19, 1924. It demonstrated its usefulness before the summer was over. The additional supply of foreign credits made possible by its operation helped to tide the situation over until October, when a currency capable of being safely expanded to meet the needs of business was provided by the Dawes Plan. Meanwhile, however, the credit shortage forced many concerns into bankruptcy, causing a crisis which was painful to the community at large but which had its beneficial effects in ridding the economic

[1]The *Economist*, London, April 30, 1927, quotes the annual report of the Reichsbank as predicting that the payments under the plan will cause "even more serious disturbances in the international exchange of goods and in the well-being of the nations which are linked up in the world economic system."

life of Germany of many mushroom enterprises.[1]

The subcommittee engaged in the drafting of the bank plan numbered among its members the sound and imperturbable Kindersley of the Bank of England directorate. It also had the assistance of an able American banker, Henry M. Robinson of Los Angeles, who, in May, 1927, was to render further service in the international field by heading the American delegation to the world economic conference at Geneva. Mr. Robinson's formal position in the survey of German affairs was that of a member of the Second or McKenna Committee. He was, however, informally coöpted by the First Committee, and though his name does not appear in its report, he served with that body during all but a brief period at the beginning. He made the essential contribution to the bank plan which only an American banker of wide practical experience could make to a scheme which above all things had to commend itself to the best financial opinion in the United States. Associated with him in this work was the well-known doctor of sick currencies, Professor Edwin W. Kemmerer of Princeton University, who was attached as an expert to the American group.

The question of the extent and character of the reserves to be required against notes and deposits

[1]In January, 1925, full ownership of the Discount Bank was taken over by the new Reichsbank, and from that time it operated substantially as a department of the Reichsbank. The loan by the Bank of England was repaid in April, 1925. See report of S. Parker Gilbert, Agent General for Reparation Payments, May 30, 1925, p. 42.

was one of the difficult technical nuts which had to be cracked. It involved the reconcilement of American practice of high reserves with continental practice of low reserves, by some form of compromise which would not endanger the plan in the minds of prospective American investors. Here Robinson's judgment and breadth of view were invaluable factors.

The provisions in the plan relative to currency notes required a reserve of $33\frac{1}{3}$ per cent. against the issue, which should be in gold or in demand deposits abroad payable in gold or its equivalent. Afterward this requirement was somewhat relaxed by the special organizing committee consisting of Schacht and Kindersley, who were empowered to translate the plan into a draft law for passage by the Reichstag. As finally enacted into law, the normal reserve against the note issue was to be 30 per cent. in gold and 10 per cent. in foreign bank notes, bills of exchange running not more than fourteen days, foreign cheques or demand deposits in foreign banks.[1]

Against its deposits, exclusive of those held for the Agent General for Reparation Payments, the bank must retain a reserve of 40 per cent. consisting of demand deposits in other banks in Germany or abroad, cheques on other banks, thirty-day bills, or callable secured loans. These requirements,

[1]Against the 60 per cent. of the currency notes in circulation not covered by the reserve there must be held discounted commercial bills of exchange or cheques satisfying certain technical requirements enumerated in the law.

as finally enacted into law, represented a relaxation of the provisions agreed upon by the Committee.[1]

The reserve provisions, both as to currency and deposits, were less stringent than the Federal reserve requirements.[2] But they were by no means lax, and in practice they have proved quite adequate.

A second important technical question was whether or not the new currency should immediately be placed on a gold basis. This was settled in the negative. This decision was obviously taken out of consideration for the prestige of the English pound sterling and other Allied currencies which were still inconvertible into gold. The unit of the new currency was ultimately to be a gold reichsmark of the same gold parity as the pre-war mark, namely, 4.2 reichsmarks to the dollar. Until absolute free convertibility with gold should be deemed expedient, it was contemplated that a similar result should be obtained by support of the currency on the exchange markets. Such support was to be given by the Reichsbank by means of offering foreign exchange for sale at or near the gold parity of the reichsmark.[3]

---

[1]The plan provided for a reserve of 30 per cent. of this character, plus a reserve of 12 per cent. in gold and gold deposits.

[2]Federal reserve banks are required to maintain a reserve of 40 per cent. in gold against their notes in circulation and a reserve of 35 per cent. in gold or lawful money against deposits.

[3]This practice was adopted with entire success. The reichsmark was easily maintained at its standard parity with the dollar. The currency has not yet been placed on a gold basis. In August, 1926, all artificial support of it was discontinued as being no longer necessary.

The major question of high international policy which directly tied in with the Committee's bank plan was that of foreign control. Connected with this was a question whether the note-issuing office and the currency reserve should not be located outside of Germany.

The Germans were prepared to accept foreign control of some rather comprehensive type. They understood the futility of expecting to attract foreign capital without it. There was, nevertheless, great need of wisdom and restraint on the part of the Committee in deciding on the exact form. Nothing which might reasonably be regarded as offensive to the dignity of the German nation would be wise. It was highly important that no legitimate excuse be given for the raising of a cry that Germany was being "turkified." In dealing with the question, it was necessary that the suspicions of the French and the susceptibilities of the Germans be reconciled.

The question was broader than that of control of the bank alone. It ran through other features of the plan as well. Any reasonable solution, in the nature of a compromise, was bound to meet with objections in both quarters. It may be said, however, that, so far as a problem of such a nature could be solved to the satisfaction of either party, the Committee solved it with conspicuous success. They made the system of control as inoffensive as

possible, leaving to the Germans, generally speaking, all operating functions, and vesting powers of inspection and veto in officials of foreign nationality to be appointed by the Allies.

In the case of the bank, the active administration of the institution, subject to certain statutory restrictions, was placed in the hands of a German president and managing board. The direction of currency, discount, and credit policies remains in their hands, while a nonoperating oversight is entrusted to an international general council of fourteen members, charged with assuring themselves that the statutes of the bank are not infringed. Half the members of the council must be Germans, of whom one (at present Dr. Schacht) is president of the bank. The other half must be foreigners, of whom one, known as the commissioner, is especially charged with control of the note issue and reserve.[1]

The question of the location of the note-issuing office and the gold reserve was at the beginning a stormy one. The French proposed that a separate issue department, with the reserve in its possession, be located at some foreign centre, such as Amster-

[1] Of the seven foreign members of the General Board, one each must be of British, French, Italian, Belgian, American, Dutch, and Swiss nationality respectively. From the beginning, the American member of the General Board has been Gates W. McGarrah, the able chairman of the Executive Committee of the Chase National Bank of New York, recently appointed chairman of the Board of Directors of the Federal Reserve Bank of New York. The commissioner, Professor G. W. J. Bruins, is a well-known Dutch authority on currency and banking practice.

dam. It was apparent to many members of the Committee that such a provision would arouse great bitterness in Germany. It was therefore contrived that decision on this highly controversial subject should be deferred while other less acute differences were being adjusted.

By the time the Committee was ready to report in April, the atmosphere of the reparation problem had cleared considerably, and the French no longer insisted that the note-issuing office and the reserve be located abroad. This being so, the proposal for the organization for the note-issuing office as an entirely separate department of the bank was dropped as having no particular significance. The plan did, however, provide that the council might, at its discretion, by three-quarters vote, transfer the issue office and the metal reserve, or either of them, to a neutral country. Later, after the adoption of the report and during the drafting of the statute of the bank, even that provision was dropped, without protest.

The object sought in the original French proposals on this subject was the essential one of protecting the integrity of the currency. But the measure proposed was incompatible with the functioning of the bank as the central feature of a currency system and an important unit in the world credit system. Currency and credit systems functions rest primarily on good faith and mutual confidence. The protective measures originally

proposed by the French were much more drastic in their nature than the system of oversight which was set up for the plan generally. They were destructive of the spirit of mutual confidence and could not have taken its place. Their immediate object is secured, in the final form which the plan took, by simple statute—depending for its validity on international good faith. The integrity of the currency is protected by the statutory provisions relating to the reserve.[1]

It remained to place a definite limit on the advances which might be made by the bank to the government. The plan limited such advances to 100,000,000 marks outstanding at any one time at not more than three months' maturity. This provision was subsequently relaxed by an amendment, dated July 8, 1926, permitting additional three months' loans of 400,000,000 marks, provided that they bear one endorsement other than that of the Reich. The purpose of this amendment was to provide the public treasury with better means of temporary financing over the periodical low points of tax collection within a budgetary year. In no case, however, is the Reich to be indebted to the bank at the end of the latter's financial year, which must coincide with that of the Reich. The reasonable presumption on which this requirement as to annual liquidation of the loans was made is that at

[1]One check only of a mechanical nature is maintained over the issue, viz., every note issued must bear the imprint of the seal of the commissioner.

the end of the budgetary year all tax collections should be completed.[1]

The central feature of the Committee's plan for the reorganization of the currency, indeed, of its entire plan for stabilizing both the currency and the budget, as well as for financing the initial reparation payments, was the proposed foreign loan of approximately $200,000,000. How one loan could serve simultaneously in all these various capacities seems at first glance incomprehensible. We shall see that the explanation lay chiefly in the fact that the payment of reparations by the German government was not to be made in foreign currencies but in marks.

It was essential that a considerable reserve of gold or its equivalent in sound foreign moneys be obtained from abroad to be placed behind the note issue. Ultimately, with the restoration of business to pre-war volume, the note issue would presumably be expanded to a billion and a half dollars, requiring (at 40 per cent.) a reserve of $600,000,000. While in its full dimensions a reserve of such size would be a matter of gradual growth and accretion, it was necessary that a considerable nucleus be provided at the start. In the judgment of the Committee, a reserve large enough to provide for an initial circulation of about half the pre-war amount

[1]The bank is also authorized, under certain restrictions, "to grant credits to the German Reich Post and the German Reich Railway to a reasonable extent, for the purposes of their ordinary business up to the aggregate amount of two hundred million reichsmarks for both."

was required. That is to say, it was necessary to obtain about $250,000,000 in gold or its equivalent in foreign credits.

Of this amount, it was not considered practical or expedient that more than $50,000,000 should be contributed as new shareholders' capital. The remainder would have to be brought into the assets of the bank as deposits. The immediate source of such deposits would be either German industry or the German government. But in the circumstances of capital depletion and fiscal and financial chaos in which the country found itself, the ultimate sources of those deposits which the bank needed would be foreign ones. If a loan or loans for either industry or the government could be arranged abroad, the gold or foreign credits suitable for a currency reserve could be made available for deposit in the bank.

The necessities of the currency situation made a foreign loan a matter of cardinal importance to the currency side of the Committee's mission. They did not furnish the primary justification for the loan, but they operated to make it a doubly useful instrument in a symmetrical plan of reconstruction. The primary justification for any loan must rest on the genuineness of the need and the adequacy of the credit of the borrower. Which was the logical borrower—industry or the government? Which could offer the essential combination of real necessity and adequate physical and moral security?

Germany, like all the belligerents, had been stripped of capital, and German industry badly needed new money from abroad. The profits which it had realized from inflation were largely locked up in new plant. But, in early 1924, the time was not ripe for industrial loans. A proper basis for the extension of private credit from abroad did not yet exist. General conditions were too chaotic. Before German industry could be given the nourishment which it needed, the currency and the budget had to be stabilized. The key to currency stability lay in the budget; and the guaranty of budgetary stability in the early stages lay in a loan to the government.

The Committee believed that the budget for the first year of the plan should be entirely relieved from any reparation burden. On the other hand, economic and political conditions in the Allied countries urgently required that a substantial reparation payment be made. The Committee was of the opinion that a reparation payment of about $250,000,000 for the first year could be assured through a contribution of about $50,000,000 by the railways and, for the remainder, from the proceeds of a foreign loan. This was the primary justification of the loan from the standpoint of the needs of the borrower. The government needed the loan in order to pay reparations, and that payment, as we shall see, was to be made by a process which was not inconsistent with the retention of the loan as a currency reserve.

The security capable of being offered was ample, always assuming that the new reparation atmosphere which the Committee was promoting could be made permanent. That security was the voluntary bond of the government of the German Republic and a first mortgage on all of its assets, to be placed ahead of the lien accorded to the Reparation Commission by the Treaty of Versailles.

The difficult part of the loan project was not in reaching unanimity within the Committee as to its desirability. Nor was it in obtaining assurances of leading foreign bankers that they were disposed to further the scheme. The difficulty lay in so preparing the ground that the loan, when offered, would be attractive to the investing publics of the United States and every financially important nation of the globe. The essential thing was a wide participation, which should offer a large margin of safety. The thoroughly sound object was to bring in the largest possible number of private investors the world over as partners in the reparation plan, and thus give the broadest and firmest possible basis to reconstruction.

With this at stake, and with the well-known timidity of capital to be taken into account, the progress toward final realization of the loan project was painfully slow.

As a first definite step, the plan as a whole had to be ratified by the governments concerned. For

various reasons, to which we shall refer in a later chapter, this did not take place until August 30th. Beyond that date, while the plan was trembling on the launching ways, the loan project still moved with the deliberation which inevitably characterizes any great credit operation. The success of the plan depended vitally on the loan; but it was evident that the loan, in turn, depended on the plan. The plan had to display a certain vitality of its own before the investor would be willing to part with his money. It had to be reasonably clear that the assumption of a new psychology of peace, upon which the authors of the plan were building, was a correct one.

Further than that, a highly special series of three-cornered negotiations regarding details of security and price had to be concluded between the German government, the Reparation Commission, and the members of an international banking syndicate. It was not until October 10th, or six weeks after the ratification of the plan, that these difficult arrangements were completed. In these negotiations, Owen Young, as first administrator of the plan, played a leading part.

The loan was placed through the strongest international syndicate of all time. It was subscribed several times over, and was in every way a huge success. Nearly half of it was sold in the United States, slightly more than one quarter in England, and the remainder, in order of the size of their allot-

ments, in Switzerland, France, Holland, Belgium, Sweden, Italy, and Germany.

The bonds were a direct obligation of the German government, and had a term of twenty-five years. They were sold to the public at 92 in a principal amount sufficient to net the government 800,000,000 marks (i.e., at 4.2 to the dollar, $190,400,000). It was provided that interest at 7 per cent. and sinking-fund payments were to be met out of the reparation annuity and in priority to the remainder of the annuity. In other words, the loan, being devoted to payment of the first reparation annuity, was in the nature of an advance to the Allies against future reparation payments by Germany.

Although the loan was not actually sold to the public until November, the signing of the loan contracts on October 10th started the machinery of the Committee's currency plan in operation. On the following day, the new bank commenced to function, as a continuation of the Reichsbank and with the same name but under a new charter. Its charter granted to it with minor exceptions the exclusive right of note issue in Germany for fifty years. Simultaneously, the new reichsmark appeared, the old mark was retired at the rate of one trillion to the reichsmark, and the gradual retirement of the rentenmark at par with the new currency was begun.

The deposit of $190,400,000 by the government in gold and foreign exchange provided the bank

with the nucleus of its sound money reserve against the note issue.[1]

It has been said that no money was ever harder worked than the proceeds of the German external loan of 1924. The loan financed the Allies, it financed the German government, it financed German industry, and it protected the German currency.

As has been said, its simultaneous employment in all these various channels of reconstruction was chiefly due to the method prescribed by the Committee for the payment of the reparation obligation. Payments were to be made by the German government, not in foreign moneys, but in marks to an Allied Agent General for Reparation Payments at Berlin. It was further contemplated by the plan that, during the first two years, the Agent General should make deliveries to the Allies in commodities which he should purchase inside Germany.

More in detail, the interesting and to many persons mysterious combination of functions performed by the loan was as follows: The foreign money proceeds of the loan were deposited by the German government in the Reichsbank. The latter created on its books an equivalent credit in marks

[1]At May 31, 1927, the reichsmark note issue amounted to $930,000,000 and the reserve held against it to $473,000,000, or 50.9 per cent. Rentenmarks still outstanding amounted to $258,000,000. The Reichsbank is not required to maintain a reserve against the latter, but it is Dr. Schacht's announced policy to do so. The excess reserve over the 40 per cent. required to be held against the reichsmark issue at the date mentioned was sufficient to provide a reserve of about 39 per cent. against the rentenbank issue.

to the order of the government[1] and the foreign money became the property of the bank. Against its mark credit, the government drew orders in favour of the Agent General, in payment of instalments of the reparation annuity. The Agent General, thus supplied with marks, drew cheques in favour of German coal operators, dye-makers, and other manufacturers, in payment for materials ordered for delivery to the Allied governments on reparation account. The filling of these orders resulted in a demand by the manufacturers for mark currency to meet their pay rolls. Such currency, as needed, the Reichsbank duly created.

Thus, month by month, to meet the requirements of new business, the currency circulation was increased in a more or less constant relationship with the amount of the reparation payments, the gold and foreign money reserve against these currency increases being already in the coffers of the bank.

The loan had two sides to it; and both sides did duty. In its dollar and other foreign-money character it established and protected the currency; in its mark character it relieved the German and the Allied budgets and financed German industry.

The Committee's plan for a new and enlarged central bank, divorced from government control and possessing practically the sole power of issue, furnished a broad foundation for the stabilization of

---

[1]This credit was under counter signature control of the Allied Agent General.

the German currency. It gave good assurance that the temporary equilibrium achieved by the Germans themselves could be merged into something approaching permanency. The foreign loan to the German government, primarily for the purpose of financing the first year's reparation payments, was, as we have seen, an integral part of the currency plan. It brought into the assets of the bank a much larger sound money reserve than any which could have been made available through the efforts of Germany alone; and by so doing supplied the basis for a currency issue adequate to the needs of German industry.

The restrictions laid on the note issue by the statutes of the bank safeguarded the new currency from two of the three possible threats to the maintenance of its value.

One of the threats met by these safeguards was of the variety which arises from an excess supply of currency. Any large excess of currency over the needs of productive enterprise would cause a decrease in its purchasing power or value in exchange for commodities. This is internal inflation of the classic type. The stock of money is expanded beyond the stock of goods in being or in process of manufacture. An inflation of that sort had occurred during the early post-war years when the government covered its deficits by the printing of paper money. Real wealth in being or in process of creation was not represented by these notes.

Such an inflation was now made unlikely by the

reserve requirements. Under those provisions 40 per cent. of the notes issued were to be represented by gold or foreign cash values actually set aside against them, and the remainder had to be covered, mark for mark, by commercial bills held by the bank, i.e., obligations of industry created to procure funds for productive purposes.

A second possible danger was of the kind which might arise from forced sale of marks on the foreign exchange market, owing to lack of public confidence in the currency. This danger also was in a large measure guarded against by the obvious strength of the reserve provisions. To the extent to which lack of public confidence might be of a more general character, linked more with international political conditions than with the question of the convertibility of the currency, obviously nothing but the success of the Dawes Plan as a whole could supply the antidote.

The remaining threat to the currency which, in the opinion of the Committee, had to be legislated against was the danger of forced sales of marks on the exchange market for the purpose of transferring reparation payments to the Allies in foreign currencies. This could not be met by any reserve requirements in the currency plan. It was dealt with by the Committee in a set of provisions laying down certain principles and regulations regarding transfers and creating a permanent interallied Transfer Committee to have supervision of them.

To that permanent body, the plan gave the power to suspend transfers if it should consider such action necessary.

The Committee considered it possible that the demand for foreign exchange for reparation payments, plus the ordinary commercial demand for the purpose of paying for foreign imports, might prove to be in excess of the demand abroad for marks with which to pay for German exports. On the exchange markets, the demands for dollars and sterling by the holders of marks would exceed the demands for marks by the holders of dollars and sterling. Stated in another way, buying orders for dollars and sterling would be more numerous than selling orders for dollars and sterling, and, complementarily, selling orders for marks would be more numerous than buying orders for marks.

The natural result of this, through operation of the law of supply and demand, would be to depress the value of the German currency on the exchange market. It would soon reach the point where it would be advisable for German importers to buy gold from the Reichsbank with marks at par and pay the gold to their American and English creditors. This would be cheaper, assuming that the Reichsbank accepted their marks at par, than to pay the high prices asked for dollars and sterling on the exchange market, for, by paying such prices, their marks would be taken at less than par.

Now, assuming this condition to be continuous

and acute, what would the Reichsbank do in the circumstances? It would have two alternatives. It would either accept marks for its gold at less than their par value (i.e., it would put a premium on gold), or it would accept marks at par. If it did the former, by that act the currency would be depreciated in value. It would be compromised. It would be inconvertible into gold, and the dangers of a psychology of panic would be brought measurably nearer.

On the other hand, if the bank accepted marks at par for gold, the supply of the latter would be drained off by export, the currency reserves would thus be depleted, and the currency of the country left without adequate backing. Precisely the same dangers as under the first alternative would be precipitated. By permitting the currency to be convertible into gold at par, the bank would, through the drain on its gold reserves, reduce it to a condition of inconvertibility.

That was the theory on which the Committee worked. But that conditions such as have been outlined were possibilities to be feared after the restoration of normal economic activity, seemed to some persons unlikely. In normal times, the demand for gold in debtor countries caused by the high price of foreign exchange has certain limits. It does not go on long, for the machinery of international credit operates in such a way as to stop it. In normal times, the machinery of world credit

is functioning properly, and it meshes in perfectly with the machinery of the exchange markets. The final compensating movement which checks the flow of gold from debtor countries to meet their obligations abroad is the granting of loans by the creditor countries. In normal times this great compensating movement links creditor and debtor countries into one harmonious system of trade, exchange, and finance.

Before the war, the excess demand in debtor countries for sterling for sale on the exchange market was matched and taken up by the offerings of sterling for loan. To-day, in the world system of exchange and credit, the dollar plays the part once played by the English pound. But at the time of the making of the Dawes Plan, the world system was out of gear. Sterling had passed or seemed to have passed, but the dollar had not yet arrived. The day when the dollar loan would be the determining factor in the operation of the world machine had not begun. The machinery of foreign exchange was trying to function without its partner, the machinery of credit. No genuine creditor rôle was being played by any nation in the world system. There were, therefore, at the time, real possibilities of danger to the currencies of debtor countries and especially of the debtor country with whose affairs the Dawes Committee was dealing.

Thus far, to the point of recognizing the dangers then existing, doubtless all the members of the

Dawes Committee were able to follow the doctrine of the difficulties of international transfer. It is not so certain that all of them followed it to the point of believing that these were permanent dangers. It is not credible that they all believed that, with the passing of sterling, the world economic system had gotten permanently out of joint, and that it was really necessary to provide permanent machinery of artificial intervention and regulation.

But there is no doubt that some of the economist members of the Committee believed, with an almost religious fervour, in the permanency of these threats to the German currency. And it is equally sure that it was the part of wisdom of all members of the Committee to give those strongly held doctrines an opportunity to prove or disprove themselves.

To satisfy the economists without infringing the principle that Germany should be burdened equally with the Allies was the major dilemma of the whole reparation problem. Here lay the fundamental conflict between the conception of reparations as a problem in mechanics and the conception of it as a case in equity. The Committee resolved this conflict by creating an instrumentality which possessed at least the forms of a permanent power of control over the transfer of reparations to the Allies. Whether or not that body has any reason, connected with its technical functions, for existence, the creation of it was a master stroke.

The fundamental formula of the Dawes Committee's solution was that the payment of reparations in German currency to the Allied Agent General should constitute "the definite act of the German government in meeting its financial obligations under the plan." The meaning of this is that, if Germany makes her required payments in marks, Germany is through, and no charge of bad faith can lie against her. The conversion of those marks into values suitable for the use of the creditor governments is the problem of the Allies.

Thus the Committee divorced the question of the internal capacity of the German people to pay taxes from the question of the external capacity of the German economy to find foreign exchange for debt payment. The determination of the equitable payment was not to be jeopardized by facts or theories regarding the restricted possibilities of international transfers.

The Transfer Committee has a membership of six. The Agent General, who is chairman *ex officio*, is an American, the remaining five members being respectively of American, British, French, Belgian, and Italian nationalities.[1]

It is the Committee's duty to authorize the

[1]The membership of the Transfer Committee is as follows: S. Parker Gilbert (American), Agent General for Reparation Payments, chairman *ex officio;* Pierre Jay (American, former chairman of the Board of the Federal Reserve Bank of New York) (succeeded, 1927, Joseph E. Sterrett); Jean Parmentier (French); Henry Bell (British); Pasquale Jannacone (Italian); Albert Jannsen (Belgian). The American members serve as individuals and not as representatives of the United States government.

regular transmittal of reparation funds by the Agent General to the Allied governments "to the extent to which in the judgment of the Committee the foreign exchange market will permit, without threatening the stability of the German currency." Its power to suspend transfers extends to both transfers by cash and transfers by commodities, since, as the Dawes Committee observed, "in their financial effects, deliveries in kind are not really distinguishable from cash payments."[1]

If the Committee should deem it necessary to suspend transfers, it is empowered to employ the accumulating fund of marks received on reparation account by investment "in bonds or other loans in Germany" up to such amounts as it may deem

[1]The reason is this. Exports made through the normal channels of trade produce foreign exchange for the account of German citizens. Much of this foreign exchange finds its way into the Reichsbank in the form of deposits by depositors who release the foreign money in exchange for marks, just as the German government released the proceeds of the German external loan. These foreign credits thus become part of the bank's reserve or are available for sale to meet the requirements of importers. Now, if deliveries in kind on reparation account should largely be made up of commodities normally exportable in trade, the result would be to divert exports from trade channels and thus to decrease the creation of new foreign exchange. For, whereas in trade the foreign purchaser pays in foreign currency, in the case of reparation deliveries the recipient government makes no payment for them at all. A depletion of the visible supply of foreign exchange thus caused by making deliveries in kind might, unless made good by foreign loans, cause selling pressure on the mark. There would be more competition in bidding for the reduced supply of foreign bills, and the position of the mark would be compromised in precisely the same way as if undue demands were made on the supply of foreign exchange for the purpose of making cash transfers.

The plan contemplated that, for the first two years, reparation payments should be made chiefly by deliveries in kind. Largely in this manner the transfer of reparations has been duly made to date. But the absence of exchange difficulties during the period has been due to foreign loans made to the German government and industry rather than to this expedient. Its real advantage lay in the stimulus which it gave to the recovery of Germany by creating an immediate demand for the products of German industry.

wise. Its charter is silent, and advisedly so, with respect to any authority to invest in shares of German industry as distinct from bonds and notes.

There was opposition both inside and outside Germany to investment in stocks. Stinnes and other leading German industrialists opposed it as a menace to their control—in some cases thinly held—of great industrial groups. And it was felt in many Allied quarters, on grounds of broad political expediency, that it would be unwise to inject foreign ownership on a large scale into German enterprise. The importunities of foreign creditors of industry may be stilled by a definite money payment; but alien stock ownership is capable of introducing a permanently disturbing factor in international relations.

In one particular, however, the ban on the acquisition of equities in German property is relaxed. The Transfer Committee is authorized to deliver marks to foreign individuals for the purpose of purchasing property of classes to be agreed upon between the Committee and the German government.[1] The purpose of this provision was to effect transfers of accumulating funds to the Allied governments by indirect and harmless means. For, under this system, the individual concerned, say a Frenchman, would pay francs to the French govern-

[1]In order that the restrictions on transfers may not be defeated by resale of such property and the conversion of the proceeds of sale into foreign exchange, it is provided that these purchases are "not to be of a temporary character."

ment in exchange for a reparation credit inside Germany, without the question of transfer arising.

This scheme for the investment by individuals in German property represents a somewhat crude and artificial approximation of the normal process of purchase of German securities which is to-day in full swing in foreign investment markets, and by means of which all complications due to reparation transfers and deliveries have been obviated.

The charter of the Transfer Committee further requires that if the total of all funds in the hands of the Agent General in Germany, "whether represented by bank deposits or loans," should reach 5 billion (thousand million) marks, "the payments by Germany out of the budget and the transport tax would be reduced until such time as the transfers to the Allies can be increased and the accumulation be reduced below the limit named."

The consideration which prompted the inclusion of this provision was the undesirability "for economic and political reasons," as the Committee put it, of an unlimited accumulation of reparation funds inside Germany. This provision represented the logical last phase of the British economic theory of the impossibility of the payment of the reparation debt.

While the French and their Latin Allies did not, by and large, take that theory seriously, they felt bound to insist on some counter safeguard to this considerable extension of the Committee's au-

thority. Their acquiescence in this feature of the plan was gained by the introduction of a provision which permits the Transfer Committee, "in the event of concerted financial manœuvres" by the German government or any group for the purpose of preventing transfers, to take such action as may be necessary to defeat such manœuvres, as well as to disregard the limit on the accumulation of funds and to employ the latter in the purchase of any kind of property in Germany.

The contingent powers granted to the Transfer Committee to regulate the accumulation and investment of reparation marks hinge on the authority to suspend transfers. That authority was granted as a wise provision against currency troubles in the early stages, which everyone admitted were possible, but which, in fact, did not materialize. It was granted, secondly, to meet possible future dangers of the same sort anticipated by the economists. Lastly, it was granted for the purpose of resolving a dangerous deadlock of opinion.

The final purpose was the one of real importance. The essential thing at the moment was to stop the bickering and give the normal processes of productivity a chance to heal the wounds of war and gradually liquidate the reparation problem. This, fundamentally, was the sound principle which underlay the agreement reached on the hotly disputed subject of international transfers.

Inherent in such a settlement was the idea that the difficulties anticipated by the economists were a bridge which did not have to be crossed until it was reached. The question was left for the future to decide. The Transfer Committee was set up to observe the test which time would make of the theory of the impossibility of debt payment. A truce to the argument was declared which should run while the agreed test was going forward.

It was of the essence of this agreement that demonstration should take the place of speculation. But the economists evidently could not be denied their Parthian shot. "The funds raised and transferred to the Allies on reparation account," says the report, "cannot, in the long run, exceed the sum which the balance of payments [i. e., in the present writer's terminology, export surplus] makes it possible to transfer, without currency and budget instability ensuing. . . . *Reparation . . . can only be paid abroad by means of an economic surplus [i. e., export surplus] in the country's activities.*"[1]

Now, there is probably no student of the reparation problem who regards it as probable that Germany's trade figures will, for a considerable period of years, show a large balance of exports. The conclusion, therefore, to be drawn from the passages cited is that the Dawes Plan will break down. Obviously, such a conclusion could not be stated in so many words over the signatures either

[1]Italics are the author's.

of those who believed in the plan or of those others who presumably were willing to sign in the forlorn hope that it might succeed. But that precise conclusion of a probable breakdown has been drawn by commentators the world over. The passages referred to have become the rallying point of a body of opinion which anticipates with some certainty a suspension of payments during the first year of the full standard annuity commencing September 1, 1928.

A suspension of payments, such as is widely predicted, would almost certainly mean a serious exacerbation of French opinion, a fall in European securities on the American market, an interruption of the flotation of new European loans in this country, and a slowing up of the movement of American exports. Without speculating upon other more serious possibilities, among them that of a renewed flight from the mark, franc, or lira, it is clear that, if the predictions regarding a suspension of payments mean anything at all, they mean a crisis of considerable proportions.

In the following chapter, we shall turn aside from the story of the making of the plan in order to examine the basis of these prophecies of disaster.

CHAPTER VII

INTERNATIONAL TRANSFERS

WE HAVE seen that the widely circulated prophecies of disaster to the Dawes Plan are predicated on the statement in the Committee's report that reparations can be paid abroad only through a German export surplus. The meaning of the Committee's dictum, in plain language, is that reparations can be paid abroad only in goods (and services). The argument based on this dogma is this: Since the reparation debt can be paid abroad only by an export surplus of goods, and since it is improbable that Germany in the near future will have an export surplus of $625,000,000 a year, it follows that the standard reparation annuity of that amount which commences to run September 1, 1928, cannot be transferred to Germany's creditors.

Stated in another way, this proposition argues the arrival next year of a crisis in the exchange market, such as was referred to in the preceding chapter. The crisis would arise from a shortage of foreign exchange offerings. The amount of foreign exchange procured by German exporters through

sale of their goods abroad and offered for marks would be insufficient to meet the demands for it. After satisfying the requirements of German importers for foreign exchange to pay for foreign goods, there would not be enough left over to meet the requirements of the Agent General for foreign exchange to make payments to the Allied governments. That is to say:

Exports minus imports equals export balance or surplus, which in the assumed condition would be less than $625,000,000. The Agent General would be bidding competitively with German importers for a supply of foreign bills insufficient to meet the combined demand. The position of the mark would be jeopardized, and the Agent General, acting under the instructions of the Transfer Committee, would be required to discontinue the attempt to transfer reparations.

To the suggestion that all this is interesting but not important, since foreign loans to Germany are furnishing the foreign exchange necessary for transfers, the Jeremiahs reply that loans to Germany on a large scale will permanently cease within a year or two, and that, even if they continue beyond that period, the only effect is a temporary postponement of a grave dilemma which grows graver still as the loans multiply and which must be faced in earnest before very long. And at this point they triumphantly cite the Committee again: "Loan operations may disguise the

position—or postpone its practical results—but they cannot alter it. . . . Reparation . . . can only be paid abroad by means of an economic surplus in the country's activities."[1]

This whole doctrine of the impossibility of debt payment has many elements of plausibility. In spite of the fact that past history does not support it, it has penetrated deeply into the economic thought of the day; and though current events are falsifying it, belief in it is still widespread.

Were it not for one sinister possibility connected with the persistence of that belief, the logic of events might safely be depended on to push it gradually into the limbo of forgotten fads. The events which furnish the practical reply to the theory are events which are part and parcel of the operation of the world credit system, and the sinister possibility connected with the propagation of the doctrine of disaster is due to the character of the foundation of credit. That foundation is confidence.

Upon the confidence of the American investor depends the continued solution of the reparation problem, both in the broad sense of a solution through the revival of Europe by American capital and in the more restricted sense of a solution through the furnishing of foreign exchange for reparation transfers. It is, of course, possible that

[1]The Committee did not repeat itself in the last sentence, as might be inferred from a comparison with the quotation on page 155. The present quotation merely completes the other one.

the confidence of the American investor in the Dawes Plan is based on complete ignorance that there is such a thing as a transfer question. More likely, he is now beginning to take note of the prophecies of disaster in 1928.

Truth justifies all things, including the circulation of pessimistic statements. But the truth of the doctrine of the difficulties of transfer cannot be said to have been established to the satisfaction of the Dawes Committee as a whole, since an organization was set up by the Committee in order to make a test of it. The curious position has therefore arisen that the high authority of the Committee is invoked in support of predictions which prejudice the test agreed upon by the members and which strike at the whole reparation settlement. For, in dealing with the intangibles of credit, in proportion to the weight of authority behind pessimistic statements, in some related degree do such statements tend to receive public credence. They attack the general credit structure, and thus, irrespective of their intrinsic truth or falsity, act "as an effective force in [their] own vindication."[1]

[1]The phrase is quoted from Professor Frank D. Graham of Princeton University, *American Economic Review*, June, 1925. Professor Graham and Professor Allyn A. Young of Harvard University are two outstanding professional economists in this country who have remained unconvinced of the soundness of the doctrines of the impossibility of international debt transfer. Professor Graham's article is a review of *The Reparation Plan* (1924), by Harold G. Moulton, and *Germany's Capacity to Pay* (1923), by Harold G. Moulton and Constantine E. McGuire, both books with the aid of the Council and staff of the Institute of Economics (McGraw-Hill Book Company, New York). Dr. Moulton has been the leading American exponent of the School which predicts transfer difficulties.

What is to be the effect of these predictions on the American investor? Is there a possibility of a psychology of panic arising in his mind? Is he to believe the authorities or not? And if he does, will he be satisfied that the only crisis to be feared is an exchange crisis which the Transfer Committee will arrest by stopping the payment of reparations to France, or will he conclude that the very stoppage of those payments will precipitate a crisis both political and economic of an even more serious kind?

It gets down to this: Do the passages in the Dawes report regarding transfers merit public acceptance? By some supporters of the plan, the raising of such a question, if not regarded as presumptuous, will be considered unwise. In their view, criticism of any part of the report constitutes an attack on the plan as a whole, potentially capable of weakening public confidence in its really constructive provisions. Is this true? Does any good ever come out of obscurantism? The fact is that, while those who believe the plan will succeed remain silent, it is in effect being vigorously attacked from the other quarter.

Let us try to break the transfer doctrine down into its components and see what it amounts to.

In examining the transfer argument, it will be helpful at the outset if we are clear that Germany to-day is saving the amount of the reparation annuity over consumption. She has an economic surplus of at least the amount of the annuity, for

the taxpayers[1] are setting aside an aggregate of that amount out of income.

If the German people continue to pay taxes to meet the payments to the Agent General, the nation will continue to produce an economic surplus to the amount of the annuity, which, commencing next year, will be $625,000,000. That amount of new capital—of tangible objects of wealth—will be saved over consumption.

We should also be clear that this wealth which is saved remains a part of the German economy. Handing over to the Agent General the title or potential title to it, in the form of marks, has no bearing on that matter at all. The Agent General is a part of the German economy. His American citizenship and his Allied responsibility do not alter that fact in the least. He is merely an office, like any other office in the Unter den Linden, which has foreign obligations to meet. His settlement of them by purchase of foreign exchange has no effect on the surplus capital in Germany. He relinquishes title to the surplus capital in exchange for title to capital abroad. The surplus capital which he relinquishes in Germany remains there or leaves there in obedience to the law of supply and demand applied to capital.[2]

---

[1]Direct or indirect. It will be seen in the next chapter that a part of the reparation charge is not a direct burden on the budget but consists of a charge laid on the railways and industry.

[2]If he delivers in kind, however, that action may set up forces leading to the borrowing of capital abroad. See page 173.

Now, one of two things is perfectly certain. Either that surplus capital—that economic surplus over consumption—will be needed at home as productive capital for industry, or it will not be needed at home for that purpose. Obviously, there is no other alternative.

Let us now recall the picture drawn in a previous chapter of the United States before the war, owing 5 billion dollars abroad. The position of Germany under the first alternative—of needing her surplus at home—is similar to that of the United States before the war. That is Germany's position at the present moment, and Germany is meeting it in the way that the United States met it. She produces an economic surplus, all of which is needed at home. She owes money abroad; she settles her current interest and sinking-fund charges on that debt by incurring fresh debt. She is a natural debtor country.

Let us now recall a second picture of the United States, this time during the early years of the war, when our country was liquidating its 5 billion dollar indebtedness to Europe. When Germany's second alternative of not needing her capital at home begins to run, her position will be similar to that of America in 1915 and 1916. She will produce an economic surplus, not all of which will be needed at home. That is, she will have an export surplus. Her exports of all kinds (both goods and services) will be more than her imports. She will still owe

money abroad, but she will be beginning to liquidate her debt by the movement of her export surplus, without incurring fresh debt. She will have become a natural creditor country in the transition state, liquidating an adverse capital balance through the export of a current surplus, preparatory to creating a capital balance in her favour.

Germany, then, in the first period, settles the current charges on an adverse capital balance by borrowing,[1] as we did before the war; in the second period, she settles the capital balance itself by an export surplus, as we did during the war.

Let us restate this and carry it a little further. If Germany raises the necessary taxes and makes the required payments in marks to the Agent General, it is incontestable that she will have a current economic surplus of at least that amount. It is equally incontestable that this surplus will either be needed for productive employment at home or will be available for employment abroad.

In the process of economic restoration the condition under the first alternative obviously comes first in point of time. The second condition will only come into being later. That this will occur at some relatively distant date seems more than likely from the facts relating to capital depletion in Europe, already reviewed. That eventuality is

[1]In 2½ years ended December 31, 1926, Germany borrowed abroad on long-term credit the equivalent of $916,000,000 (S. P. Gilbert, report June 10, 1927, p. 63) of which about $800,000,000 was American capital (Dept. of Commerce, Trade Information Bulletin No. 503, p. 38).

in the future, say five or ten or even fifty years from now—no one can say just when. Meanwhile, Germany pays by borrowing.

But, the question is asked, when the second condition does in fact arise and Germany actually has a surplus available for export, will that surplus be exportable? Will the world take it? Will the world want German goods and capital to that extent? The answer which we hear is that it will not. Foreign industries, it is said, will resist such a movement of German goods as a menace to their markets, and in particular the French will resist it from reasons of racial antipathy.

It is not given to man to pierce the distant future. And it is not in all circumstances useful to try. Speculations regarding Germany's future export surplus are still, as they were in 1922, classic examples of the academic question strayed into the field of practical affairs. The effect of interjecting into an already highly involved practical subject such essentially unanswerable questions is to throw one off the track. The practical question is, will the transfers under the Dawes Plan be met in 1928 and immediately thereafter?

But academic questions, if they can be recognized for what they are, and so segregated as to be rendered harmless, are not without their interest and usefulness. Moreover, to decline to meet the economists on their favourite ground would savour of dodging the issue. Let us, therefore, look at that

particular speculative question which relates to Germany's future export surplus.

The question posed is, "Will the world take $625,000,000 worth of German goods, at that future date, perhaps in five years, perhaps in fifty, when Germany no longer requires its capital at home?"

In approaching this question, a doubt may be expressed whether it has any bearing on the reparation problem at all, since the life of the reparation problem may well prove to be shorter than the time during which a German export surplus is developing. For, with the passing of time, the need for reparations in relief of the taxation burdens of the Allies will decrease, and when the debt, which is plainly a fertile source of international friction, no longer serves any predominatingly useful end, it may be expected to disappear from the political landscape.

Passing over this possibility, however, let us briefly examine a number of considerations which the economists, in supplying us with a negative answer to their question, have ignored. Their assumption, it will be recalled, is that the German surplus of $625,000,000 will not be accepted by the outside world when that time comes when Germany does not need it at home.

In the first place, we need perspective. We need to disabuse our minds of the idea that the German surplus of which we are speaking will represent any considerable proportion of the operations of world

trade. To-day more than 50,000 million dollars' worth of goods and services move annually in international trade. It should not be necessary to labour the point that fifty years from now, or even five years from now, $625,000,000 will be relatively a much more insignificant sum than it is at the present time. New wants of mankind are continually arising, and new areas of customers' demands are continually being opened.

Secondly, we may question the soundness of an assumption that Germany, or any nation, when her economic effort begins to turn outward, will not develop her system of foreign trade and finance commensurately with the need for disposing of her surplus. When German industry becomes so efficient as to turn out more new product than can either be consumed at home or ploughed back into new productive capacity at home, it is wholly likely that German energy and efficiency on the world market will be equally notable.

Lastly, we may ask whether "dumping menaces" are not legendary monsters. We should bear in mind that the movement of German goods which the economists predict will be resisted by foreign industries as dangerously competitive will in fact be capital flowing to debtor countries in the world system to supply capital needs. In the receiving country, such an influx does not strike at the product of industry as a whole, though individual industries may feel it. It supplements the prod-

uct of an industrial system which, as a whole, is inadequately developed to meet the demand in its own markets, and simultaneously it injects that much new capital into the country for the use of industry, with the result of enhancing its productivity. It fills a capital vacuum.

Dumping menaces are creatures of the fears of manufacturers who have given little consideration to the matter of capital supply and demand. When a country is short of capital, it is short in productivity, and its excess imports fill the dual function of satisfying the demand for capital and increased productive capacity on the one hand and for product on the other. Tariffs will not keep this inflow of capital out; and the manufacturer, when he gets to the point of needing capital to finance new productive capacity, is the last one who should wish them to do so. Nor is race prejudice likely to keep it out. Are the borrowers any more likely to refuse German capital than English or American capital?

In a world at peace, with constantly expanding markets, it is safe to say that a German surplus will flow out to debtor countries as readily and acceptably as an American or a British surplus. And by this movement there will be created foreign exchange of various kinds in various amounts for the use of the Agent General—a little here and a little there—in transferring payments to the Allies.

Now, if part of this surplus were to be taken directly in kind by Germany's reparation credi-

tors, the problem would be still simpler. What is to be said of the probable future attitude of those creditors, particularly that of France, to whom half the sum is owed? Will France refuse to take goods in kind? Will France, needing relief for her taxpayers, decline to receive German goods in payment? She will, if the economist school can persuade the taxpayer that the boycotting of German goods will result in indirect benefits to him of greater moment than the direct benefits of tax reduction.

The chances of such an argument being received with great favour in France cannot be said to be good. The whole history of the reparation problem shows that the French are not impressed by the doctrines of the economist school. The French have consistently been the leading exponents of the idea that a tax is a tax, all theories to the contrary notwithstanding. The French have consistently taken large amounts of deliveries in kind on reparation account, and so long as their need for reparations exists they may be expected to continue to do so.

This is not to say that, with changed conditions, the character of the deliveries in kind to France will not change. To-day the need of France for continued deliveries of coal appears to be lessening. But other requirements will take its place. At present, the suggestion is that German materials and possibly labour be supplied in connection with large public works programmes in France and the

French colonies, including hydroelectric projects, railroad building and electrification, canal and port improvements, the building of coke plants and the development of coal mines. Doubtless fifty or a hundred millions a year could easily be absorbed in these ways, and the payment of such sums for ten or fifteen years would make a considerable hole in the reparation debt. It seems entirely safe to assert that, if there is a will to pay, there is a way to receive.

Discussion of the more or less remote eventualities associated with the subject of Germany's future export surplus is pleasant exercise. During the past several years, it has provided much innocent intellectual entertainment for students of the reparation problem. On the whole, however, it has proved too diverting. It has enveloped the reparation question in a fog of speculative controversy, behind which the whispered predictions of the knowing on the subject of the expected breakdown of the plan in 1928 have gone unchallenged. Let us now examine those predictions a little more closely.

To-day, the fact is that the reparation debt is being paid and transferred against dollar and other foreign-currency[1] loans to Germany, or, more accurately, it is being transferred partly in cash against loans and partly in deliveries in kind, and

[1]It seems scarcely necessary to demonstrate that in these settlements dollars, sterling, guilders, and other foreign currencies are as useful to France as francs, being available for settlement of her foreign obligations, both commercial and governmental.

the latter in their capacity as capital taken out of Germany are being replaced in the German economy by loans.

That the foreign exchange procured by loans will continue to be available for transfers to the Allies and for payment of interest on Germany's commercial debt, instead of being completely used up by the borrowing industries for the purpose of buying goods for import from the United States or elsewhere, is a reasonable assumption. It is supported by past history of the financial operations of large debtors in the world system. A large part of the foreign credits required by the industries of Germany, or any country, is needed for purposes of domestic expenditure. When, in the case of Germany, loans are obtained in the United States, a portion of the dollars thus procured is surrendered by the borrower to the Reichsbank in exchange for marks, the latter being procured by the Reichsbank from the Agent General in exchange for the dollars which he requires in order to make transfers.[1]

Now, as long as Germany needs foreign capital it is evident that the transfer of reparations will continue to be effected against loans. And when Germany no longer needs foreign capital, it is evident that it will be for the reason that she has an export surplus of her own, available for the making

[1]Dr. Schacht in his recent book (op. cit., p. 120 above) states that the conversion of foreign loans into marks at the Reichsbank for home use is by far the more frequent form of disposition made of such loans by the German borrowers. For his further remarks on loans, see below (p. 257).

of transfers. Is there any intermediate point between these two conditions? Is there any dead centre at which international economic processes in a world at peace will arrive, after the first condition has ceased and before the second has begun? The economists would have us believe that there is. Let us look at that hypothesis.

In this particular area of the defeatist doctrine, the assumption is that, in a year or so, Germany will no longer need any more foreign capital, but that, nevertheless, it will have no surplus capital for export. The idea is that Germany would be in a perfectly neutral position in the world system, producing precisely enough new capital to meet her own internal requirements, but no more.

The flaw in the theory is this: The Agent General, through his bank balances, will be holding title to an economic surplus in Germany, which, as we have seen, is being produced in at least the amount of the reparation annuity, through savings effected by taxation. This year (the fourth year of the plan) the surplus thus produced is $437,500,000. Next year, under the full standard annuity, the surplus thus produced will be $625,000,000. Every month, then, on an average, $52,000,000 worth of new capital will be saved out of production. The rights over that new capital become vested in the Agent General through the payment to him of marks raised as taxes. Now, the second part of the assumption of the economists is that the commodities

representing this surplus capital are not to be regarded as an exportable surplus. It is assumed that they are needed at home, to be ploughed back into new productive capacity—to be invested, in other words, in new domestic security issues. But, as we have remarked, the Agent General has title or potential title to these goods. Suppose, then, that he exercises his rights over them at the normal rate at which his purchasing power accrues, i. e., some $1,700,000 a day, and starts sending them over the frontier as deliveries in kind to the Allies. What is the result?

The result is this: At the rate of $1,700,000 a day, Germany, which by the hypothesis is not in the market for foreign capital, is automatically placed in that market through the depletion of that stock of capital which by the hypothesis she needs at home. The dual assumption of the economists will not work at all. As long as the Agent General has a cheque book, Germany cannot be in a neutral position regarding capital supply. She will have to get capital from abroad.

The picture drawn in the preceding paragraph of a gradual day-by-day action and development of economic forces deserves to be borne in mind in connection with almost any phase of the doctrines of the pessimists. Much of the plausibility of their theories arises from formidable but quite unreal pictures of an unwieldy accumulated demand or supply suddenly thrown at German production,

at the German currency system, at the world system of exchange, or what you will. It is a fundamental weakness of all their various hypotheses that they see $625,000,000 worth of marks or goods, banked up in one unmanageable mass, ready to be dumped into the cogs of the world machine all at once.

But the system of reparations and the world system into which it meshes do not function in that way. They do not operate by fits and starts, interrupted by long intervals of passivity. They operate not through a spasmodic series of violent movements, but continuously, day by day and dollar by dollar. Millions of economic beings, like ants, are busy every hour of the day with their little concerns, all contributing their part to a broad, resultant movement in which adjustments have been made as the necessity for them arose. With pressure here and recession there, little by little the vastest movements get under way and are absorbed without noticeable strain, while simultaneously their compensatory processes are brought almost imperceptibly into action. A few small streams of reparation transfers trickling hour by hour into the sea of international trade and finance will scarcely produce a ripple upon its broad surface.

Out of the failure of economists to visualize the workings of the world system as it is came the new doctrine of a certain mechanical impossiblism in the operation of economic forces. It sprang up at the

outbreak of the war. Such a war, economists said, would prove economically impossible after a few months' time. The new phase of the doctrine—the economic impossibility of transfers—is that first colossally mistaken hypothesis carried over into the era of war settlements. The fact is, of course, that economic forces have not a primarily mechanical nature at all. They arise out of the aspirations, the capabilities, the courage and the fears of millions of human beings. If the burden of a debt is not physically and morally beyond the capacity of a debtor, if the debtor wants to pay and the creditor wants to be paid, the idea that some mechanical difficulty inherent in the operation of economic forces will prevent payment is mere superstition.

The Committee's dictum that "loan operations may disguise the position or postpone its practical results but they cannot alter it" has a disquieting sound to the layman, and justly so, considering the authority. It plainly carries an implication of the breakdown of the reparation settlement. For loans are the only solution of the reparation problem which is in immediate sight. The layman is told that loans merely disguise the position. He is told this, moreover, in brief and uncompromising language, without elucidation, as if it were the statement of a truism.

This cryptic statement has great plausibility. The answer to it is that it is the expression of a

highly special state of mind. When we examine the assertion in the perspective of the great swings of world trade and finance we recognize that state of mind for one which accentuates a point of time and not a period—a crisis and not a process—the turn of the tide and not its ebb and flow. The British economic mind regards as significant, not the experience of a world moving healthily through its new cycle of capital distribution, but the event which will happen at the end of the cycle. It seizes upon the fact that the United States, during the war, settled an accumulated international balance by a gigantic export of goods, and it marks that isolated and wholly abnormal event as the key to the operation of the world system. Obviously, it is nothing of the sort.

The fundamental assumption of the Dawes settlement was a condition of economic normality, to be induced by a cessation of purposeless controversy over what will happen in the more or less distant future. Broadly, the world system has now begun to function normally, with a new set of natural debtors and creditors. It may well be that, at some future time, an extraordinary consumers' demand like that of the late war will arise in this country and turn the tide of goods suddenly back again. Alternatively, it may be that the tide will turn only gradually, in obedience to forces of a beneficent character, fulfilling complementary needs of the nations concerned. Or, again, it may turn back

through indirect channels, whereby we shall receive non-competitive products of third-party nations, settling Europe's obligations here as an offset to their obligations to Europe.

But, by whatever means it comes, it may reasonably be believed that the event is a long way off, and it may be accepted as certain that not even the wisest economist can possibly foresee the date, the circumstances, or the effects of its arrival. With their eyes fixed on this speculative future event, British economists make the extraordinary demand on our common sense that all economic life in the meantime is to be regarded as temporary, abnormal, and dangerous. Truly, the passing of sterling seems to have had an unsettling effect on the minds of our hard-headed cousins across the water.

Meanwhile, in these movements of great economic forces, what is the function of the Transfer Committee?

Contrary to a still rather prevalent belief, the Committee possesses no general power of control over the foreign exchange operations of Germany. It cannot forbid the acquisition of foreign exchange by German nationals or specify the purposes for which it shall be employed. In particular, it has no power to authorize or to decline to authorize the transfer to foreign bond-holders of interest or repayments of principal of German commercial debt payable in foreign currencies. Its control over foreign exchange is limited by its charter to forbidding

the transfer of reparation payments by the Agent General of the Allies.

Its other powers are all contingent on the exercise of that one; and that power may be exercised only if a majority (or three, including the chairman) of its six members are of the opinion that the transfer of reparations would constitute a threat to the stability of the German currency.[1] In practice its function is that of an observer. In practice, the transfers of reparations go forward as a semi-automatic process resulting from the operation of economic forces.

It must be considered fortunate that the power actually granted to the Transfer Committee to suspend reparation transfers falls considerably short of the implications of one passage of the report of the Dawes Committee. In that passage the conviction was expressed that a policy of "continuous expert administration in regard to the exchange" was essential to the solution of the reparation problem. This provision seems to be in the nature of a safety valve through which the suppressed desires of the professional economist minority within the Committee were harmlessly blown off. If the

[1]On this question, as on all other questions but one, the chairman, in case of a tie, has a casting vote. It is to be noted that, if the two American members vote together, the vote of one other member would give the two delegations together a voting majority over the remaining three delegations. The possibilities in such a situation are food for thought. In case of a tie vote on the question whether concerted financial manœuvres have been set up, it is provided by the London Agreement that the question shall be referred to an arbitrator selected by the Transfer Committee in agreement, or in default of agreement, by the President of the Court of International Justice at The Hague.

erection of a great machine of supercontrol over the exchanges was on the cards, the Committee is to be congratulated on having resisted the idea.

Schemes of this sort are always alluring; and in these days many of them have the added attraction of carrying the approval of the very class which not so long ago was unanimous in warning mankind of their dangers. It is no longer solely the politician who is tempted to tamper with the natural flow of economic forces. Great instruments of artificial economic regulation are to-day the passion of the economist. The profession has its dreams of an imperial sway over a standardized world in which the rôle of statesmanship will be a secondary one. While government, in the discharge of its duty to protect the public from exploitation, to-day steps into the domain of business with a certain cautious regard for the evils of over-regulation, our modern economists rush eagerly in with grandiose conceptions of "managed money," of credit control and price stabilization on a vast scale, and of "expert" manipulation of the exchanges.

Should we not ask ourselves whether the science of economics to-day is not in danger of mistaking its calling? It is true that economic life to-day is vastly complicated, and that man needs science more than ever before. But he needs a servant and not a master. Complex though modern economic life is, the judgment and the initiative of the individual must still be the determining factors in its

processes. Economic forces are the resultant of the exercise of scores of millions of individual judgments. The time has not yet come when forces such as these can be displaced by any single mind or small group of minds, or when efforts to displace them by such inadequate instruments will not be fraught with danger. The individual producer, merchant, banker, or investor, in his scores of millions, must still form his own judgments and take his own risks. When he ceases to do those things, economic life will be hopelessly sterilized and stereotyped.

To-day, as in the past, economic science can best serve the individual by giving him facts. In modern conditions, what the individual needs is a wider range of information upon which to base his judgments. What he does not need is paternalistic regulation, either bureaucratic or expertocratic.

The delusiveness of any scheme for regulation of the exchanges would lie in the fact that no mere human mind, however "expert," could encompass all the phenomena necessary of comprehension if an autocratic power over the economic activities of millions were to be beneficently exercised. The danger of such a grant of authority would lie in the possibility that its recipients would possess their normal share of human vanity, and in consequence would be unable to resist the thought that the safety of the race required them to act.

During the negotiation of some of the first foreign

loans placed in Germany after the creation of the Transfer Committee, American bankers were disposed to look to it for assurances relating to the transfer of payments of interest and ultimate repayments of the principal of the loans. The limitations of the Committee's powers were not clearly understood, nor was it apparent to all that the safeguards sought would be delusive.

The natural control over the making of international loans lies in the judgment of the lenders or their bankers regarding the solvency and earning capacity of the enterprises concerned and the general stability of the country. Credit criteria must govern the granting of credit. A power to regulate the making of loans to Germany, derived from an authority to regulate the ultimate retransfer of the principal to the investor, would be a control of new capital issues based on considerations wholly alien to the natural criteria of credit and highly theoretical in their nature.

Such a control, if it interfered with the natural movement of capital, would threaten the revival of productivity which that movement has stimulated in Germany and the countries to whom Germany is now paying reparations. It would strike at the very processes which are now solving the reparation problem and what little remains of the German currency problem. The longer foreign loans continue to be made to Germany in response to a natural demand—and it appears that such a demand will

not soon be satisfied—the longer will reparation payments continue to be transferred against the foreign exchange which they create, and the nearer will come the day when the reparation problem will be completely swallowed up by the white corpuscles of international finance.

The formal powers of the Transfer Committee, however, do not embrace the control of any private financial transactions whatever. They are restricted to authority to suspend the transfer of reparation payments. Whether that power is a safeguard in the international situation or a threat depends on whether one agrees with the theories of the economists or not. To the writer, it seems in the nature of a contingent threat to the healing processes which have resulted from a restoration of confidence and a reëstablishment of European credit.

But the contingency is probably only a remote one, for, despite the predictions of a transfer crisis in 1928, it seems unlikely that the power of the Committee will ever be exercised. The power to suspend transfers of reparations has not the allurement associated with the manipulation of the more strictly commercial relationships of the world system. It is primarily political in its significance. For some time to come, the authority conferred upon the Committee to suspend transfers will plainly be nothing more nor less than permission to let loose political forces of a highly explosive nature. It seems likely to be a long day before a voting ma-

jority of the Committee will be convinced that such a remedy for some predicted instability of the German currency would be any remedy at all. In this situation, the position of the two American members, with the potential third and casting vote of one of them in case of a tie, is crucial. If an agitation for suspension of transfers arises, much will depend on their courage and judgment. These qualities Mr. Gilbert and Mr. Jay, the American incumbents, unquestionably possess.

Out of the foregoing discussion, the question naturally arises whether any real advantages resulted from the creation of the Transfer Committee. The answer is decidedly in the affirmative.

The introduction of this novel instrumentality into the structure of the plan bridged the chasm between the taxpayer school and the economist school of reparation thought—between those who believed that the amount of reparations to be paid ought to be determined on the principle of equalization of national burdens and those who believed that it would, in actual fact, be determined at a considerably smaller amount, fixed by the limitations of Germany's export surplus. As we shall see in a subsequent chapter, the Dawes Committee assessed the figure as closely as possible to the equitable basis demanded by the taxpayer school, while giving satisfaction at the same time to the economists by creating a committee with a contingent power to suspend payments.

To the economists, the great merit of the scheme lay in that grant of power. To those others who found it inconceivable that the reparation problem could ever be settled unless Germany actually paid on an equitable basis, the supreme practicality of the device of a Transfer Committee lay in its soothing properties. To them it appeared to be a suitably seasoned dish of meat thrown to the economists to keep them quiet. It insured that a plan dedicated to the idea that reparations could be paid would get over its first hurdles without being sabotaged in any vital part.

Once organized, the Transfer Committee became the most important of the forms set into the mould of the plan to keep the hot metal in place until it had hardened. It assisted, and it still assists, in maintaining confidence during the preliminary period. Economists have the satisfaction of believing that it will step in with a suspension of payments when their crisis in the exchange market materializes. Less scientific persons have the satisfaction of feeling certain that votes will not be forthcoming which will enable the Committee to do anything so rash.

The prophecies of an exchange crisis seem to have no objective foundation at all. Seemingly, the only crisis possible is a subjective one—a depression in the market for European securities brought on by those pessimistic predictions themselves and culminating in a crisis of the very kind predicted.

It is difficult to believe that this will happen, though it may be heresy to suggest that the American banker and investor will ignore the economists. If the banker and investor do succeed in preserving their independence of the high priests of the new economics, it seems as certain as anything in the future can be that the much-heralded crisis will run its course inside the economic crania, without doing any practical damage to the rest of the world.

Meantime, while the question is pending whether the high tide of economic faddism came in 1922 or is still to come in 1928, the Transfer Committee has taken its place as an effective instrument of economic science in the field of the latter's real usefulness. Its researches into various aspects of Germany's economic life constitute an indispensable contribution to the factual background of the reparation question. These highly objective and admirable studies cover the economics of the German phase of the problem since 1924. The equally important Allied phase, however, has yet to receive similar attention.

Such a restriction of the illuminating power of facts to one side of a dual question contains elements of danger. One side is in the light, while the other side is, relatively speaking, in the dark. The economist school was convinced that the reparation problem concerned only Germany's capacity to bear burdens. Germany's capacity was to be determined without reference to the capacity of

France. When the influence of that theory has been more thoroughly eradicated, it may be that the fact-finding functions of the Transfer Committee can be extended so as to include the other phase of the problem. That phase is France and French taxes. If the Transfer Committee could forget about transfers and think about taxes—taxes on both sides of the Rhine—it would have a thoroughly useful and engrossing occupation.

Let us now turn to that phase of the work of the Dawes Committee.

CHAPTER VIII

ASSESSING GERMANY'S CONTRIBUTION TO RECONSTRUCTION

THAT part of the Dawes Committee's task which concerned the German budget was dealt with by a subcommittee headed by Sir Josiah Stamp. Like its companion subcommittee on the currency, it brought the subject matter of its work under the constant review of the full Committee.

The members of the Committee as a whole never relinquished close contact with any one of its major problems, whichever subcommittee nominally had cognizance of it. In fact, the division of the Committee's work between the two subcommittees had reference principally to consideration of the more technical aspects of bank and currency practice on the one hand and fiscal practice on the other.

This division scarcely applied to such subjects as the loan, the foreign control, the transfer organization, the project which we are shortly coming to for the burdening of industry and the final determination of the total burden on the German nation. On such matters, any real departmentalizing of the Committee's task under the one or the other

of the two clauses of its charter would have been impossible. All members of the Committee contributed to the shaping of those important aspects of the plan according to their predilections and their abilities.

As defined by its charter, however, the two grand divisions of the Committee's mission were the currency and the budget. These were closely interrelated. A practical solution of the budgetary problem was impossible unless the currency plan succeeded, for without a stable currency the difficulties in the way of laying and collecting adequate taxes would be insuperable. The reverse of this was also true. Without a proper budget plan, including a satisfactory provision for reparation payments, it seemed certain that the hold of the French on the Ruhr would be maintained, the "flight from the mark" would be renewed, and the plan for the reorganization of the currency would be defeated.

From this endless chain of malignant causation, only one thing could rescue Europe—a bargain between the two parties chiefly at interest, in which each would contribute what the other most wanted. Clear heads on the Committee saw that the basis of such a bargain had come to exist. France wanted reparations—something which it was within the power of Germany to assure. Germany wanted currency stability—something to which France had the key in her grip on the Ruhr.

It is scarcely to be doubted that the invasion of

the Ruhr had a deep inevitability. It was that event which supplied the first touch of realism in the reparation controversy and brought the affairs of France and Germany back to the contractual basis which is the only possible foundation for the peaceable conduct of international relations.

The exchange of valuable considerations is essential to the idea of contract. In its reparation clauses the Treaty of Versailles implicitly assumed an absurdity—the voluntary payment of a huge indemnity, despite the absence of any compelling consideration of self-interest for Germany. The occupation of the Rhineland under the terms of the Treaty did not adequately supply such a factor. It involved considerations affecting the pride of the German people, but not their economic necessity. A deeper necessity which Germany was under of rehabilitating herself in world opinion by making restitution to France was too vague and remote to supply the motive for the payment of a large debt. It was, besides, largely negatived in the minds of the German people by the campaign which minimized the damage caused to France by the war.

Under the Treaty settlement, Germany was well enough off if the matter of reparations were allowed to drift; and no such impossible degree of altruistic feeling for the plight of France existed as would supply the corrective. International altruism with no backbone of self-interest is sheer Utopia. One does not have to defend one's self from the charge

of undue cynicism in recognizing that there must always be a *quid pro quo* in international affairs. Between the friendliest nations—and Germany and France were not that—important national sacrifices can rarely or never be successfully urged at home unless important national advantages can be plainly shown. Political leaders who point to remote or intangible benefits in justification of a policy of national sacrifice invariably have to answer the charge of disloyalty to a national trust; and few of them are strong enough to stand up under it. In Germany, after the war, a policy of Treaty fulfillment was almost impossible.

At the time of the Armistice, the fear was expressed in many Allied quarters that the war had not been sufficiently brought home to Germany. The Germans, it was said, had not experienced the rigours of war at such close range as to insure their voluntarily playing their full part in the reconstruction of Europe. The implication was that an armistice should be refused until the war had been carried into Germany.

It was a savage and impossible idea. But it was not without its profound basis of truth. It recognized that the German as a political animal is no more intelligent than the rest of mankind. It recognized that in the Twentieth Century of the Christian Era the intelligence of political man seldom functions spontaneously in the area of his international obligations. Man, as an individual,

in his private and to some extent his national affairs has learned the art of living with his neighbours. Collectively, as a tribe, he still rarely sees, until some form of physical discomfort brings it home to him, that a decent regard for the welfare of other nations is important to his own well-being.

The nations of Europe, after the war, were struggling to emerge from a régime of unmitigated force to one founded more nearly on free contractual relationships. Before they could do so, the one-sided situation created by the occupation and devastation of northern France had to be rectified. The occupation of the Ruhr redressed the balance. France was no longer a mere suppliant before the bar of international justice. She assumed the position of an equal negotiator.

Poincaré's justification of the occupation on the ground that a German "will to pay" had to be created was in its essence neither so harsh nor so futile as his critics believed. The German need for relief from the horrors of a depreciating currency came to assume an equal intensity with the French need for reparations. That relief the French, and only the French, could grant, by releasing the pressure in the Ruhr, and thus contributing an essential element of the credit background necessary for the reorganization of the currency. The establishment of a proper schedule of reparation payments was the key to the situation. An effective desire by the Germans to meet such a schedule

might be expected to provide the remaining credit factor essential to the importation of foreign capital into Germany.

The German industrialists held, or had held, the strings to the situation in their hands. They had benefited enormously from the depreciation of the currency, and had waxed in power and arrogance accordingly. Until the occupation of the Ruhr, some of their conspicuous representatives had shown an attitude of indifference or hostility to the payment of reparations and thus to the relief of a situation which bore very hard on the plain German. At the conference at Spa, in 1920, relating to coal deliveries to the Allies, Stinnes, the great coal and iron operator, had been blatantly defiant.

With the seizure of the industries of the Ruhr, a change in the attitude of the industrialists was foreshadowed. When passive resistance broke down and government aid ceased, that change became an accomplished fact. The magnates showed some responsiveness. They were not suffering directly from the effects of the depreciation of the currency —far from it—but the circumstances of the occupation which prevented the recovery of the currency had suddenly become dangerous and detestable to them.

When the Committee met, the industrialists had seen a great light. No one wanted the French out of the Ruhr more than they did. While their direct interest was in regaining control of their properties,

it harmonized perfectly with the interests of the rest of the nation, which was unanimous in wanting to be rid of the effects of the occupation on the currency. Workingmen particularly were in this respect thoroughly sound in their economics. They were quite clear that inflation was a curse, and it was from their representatives that the Committee received the most moving of all the appeals registered for a currency which would protect persons of moderate means from destitution.

All such appeals the Committee answered with the reminder that it was for the Germans themselves to make their own relief assured. Do you admit, they asked, the justice of a burden of taxation being placed on the German people which will be equal to that carried by the Allies? Are you prepared, they asked the industrialists, to accept a tax on the profits of inflation which will make a large total yield from national taxation possible? The answers were in the affirmative.

With gratifying unanimity, the representatives of all classes of the German people showed a wish to contribute effectively to the reconstruction of Europe. To the keen judges of human nature who were numbered among the members of the Committee, the German responses seemed sincere and spontaneous. Many Germans were seeing things in a more just perspective. The corrective of the Ruhr, beginning in violence, was ending in peace. It was Admiral Mahan, we believe, who said that

the proper function of force is to give moral ideas a chance to take root.

The shift of wealth which had resulted from the depreciation of the currency was the key to the budgetary problem. Industry had been enriched at the expense of the holders of its now worthless obligations. The extensive class of small investors who held bonds rather than stocks had been wiped out by the destruction of the value of all fixed obligations, while the owners of real property, the shareholders or part owners of corporate assets in the form of plant, machinery, and materials, had correspondingly benefited. The holders of government obligations had been impoverished by the equivalent of a terrific intensification of taxation for debt retirement, imposed on them within a brief period of time instead of on the taxpayers at large over a much longer period.

The boundaries and composition of these various classes—bondholders, shareholders, and taxpayers—were only vaguely determinable. These classes were by no means distinct. They overlapped and were partially intermingled. Broadly speaking, however, it was the great middle class which had suffered most from depreciation of the currency. The savings of the frugal had been swept away by the cancellation of debt; and salaried men, small professional men, and, to a lesser extent, labour had suffered from the lag in the upward adjustment of their compensation. The poor had become poorer

and the rich richer. It was as if a gigantic suction pump, driven by the engine of inflation, had played over the country and drawn all the savings of the population at large out of their pockets into those of the Ruhr magnates.

This internal shift of wealth, however, had not resulted to any great extent, if at all, in diminishing the total real wealth of the country. It was an essential part of the Committee's mission that an effort be made to reach the accumulations of shifted wealth for purposes of taxation. There was a considerable movement in Germany—which has since borne fruit in legislation—for the reinstatement of small percentages of the original value of various categories of depreciated debts. The effect of this on taxation, however, was slight and incidental. The Committee proposed that a large blanket charge of taxation be immediately laid on industry, including the railways, but excluding agriculture. If this could be done on an adequate scale, the problem of laying a national charge of taxation approximately equivalent to the burden resting on the Allies would be greatly simplified.

A project to place a special tax on these properties for reparation purposes had, in fact, been submitted by the German government in its note to the Allies of June 7, 1923. It was then only a half-formed idea, and the government itself at that time would palpably have been unable to give effect to it. The industrialists were too strongly intrenched.

The Committee adopted the scheme with modifications.

Of the total standard annual charge on Germany, as finally agreed, a half, or $312,500,000,[1] was laid directly on industry, the railways, and railway traffic. The remaining half was to be borne by the budget of the Reich, with the proviso that if, in the opinion of the German government, the budget ought to be further relieved by specific taxes on other forms of property, such a course should be followed.

The charges laid upon industry and the railroads were effected through the creation of first-mortgage bonds in a total capital sum of 4 billion dollars, running to the Allied creditors of Germany. The annual charge on these bonds at 6 per cent. (of which 5 per cent. was interest and the remainder sinking fund) was $240,000,000—a charge which would run for 40 years, i.e., until the retirement of the bonds by operation of the sinking fund. Added to this was a transport tax of $72,500,000, to be paid by the railroads.

The project for the creation of the mortgage bonds had several striking advantages. It was calculated to take a considerable part of the financial

[1]That is, 1,250 million gold marks. Officially, all reparation obligations and transactions are stated in gold marks, but for convenience they are stated by the writer at their dollar equivalent. This is calculated, except where otherwise mentioned, at the approximate rate of four marks to the dollar. As the value of the mark at gold par is about 23.8 cents (4.2 marks to the dollar) the dollar amounts, if calculated more exactly, would be 4.8 per cent. less than the approximate amounts used in this book.

aspect of reparations out of politics. For the bonds were primarily of a commercial character. The annual return from them was dependent, not on the vicissitudes of fiscal legislation, but on industrial earnings. When the appropriate time should come for marketing them, that part of the reparation debt which they represented would be definitely absorbed into the world commercial system; and the proceeds of their sales to investors would fall as capital sums into the impoverished treasuries of the Allied governments.

Moreover, to Germany the scheme was of incalculable value. Facing an imperative public obligation of large size, the nation was also confronted by that iron dilemma which, in a society dependent on accumulations of capital, everywhere defeats the principle of taxation according to ability to pay. The Committee seized upon and turned to Germany's advantage the extraordinary circumstances of the moment which made it possible for Germany to find a partial escape from that dilemma. The reparation crisis had delivered the industrialists into the hands of the government.

The charge laid by the Committee on industry proper was less than a third of the combined charge on industry and the railroads. The German government had suggested a mortgage on industry amounting to 2½ billion dollars, and had proposed that agriculture carry a share of it. The Committee did not concur with that part of the

proposal. It believed that there was considerable risk in including agriculture in the scheme. The decline of agriculture which had come with the modern swing to industrialism was not a factor to be lightly ignored. The American members are both known from their public utterances on the subject to be keenly aware of the importance of the modern agricultural problem and to entertain a highly sympathetic attitude to the farmer. The Committee, as a whole, shared these views. It came to the conclusion that it was not justified in recommending a special burden on the agriculture of a nation which, in the Committee's words, "is unable to provide its entire food supply."

The Committee was conscious that the owners of agricultural properties, like all owners of equities in land, had realized through inflation substantial profits at the expense of their former creditors. But it was also convinced, we may infer, that for a long time society's basic industry had not been offering sufficient attractions as a vocation. From 1882 to 1907 German agriculture, measured by occupational statistics, had suffered a startling decline, the percentage of the population engaged in its pursuits having decreased from 42.5 per cent. to 28.6 per cent. For a long time, agriculture had obviously been out of line with other industries, and the Committee was unwilling to assume that any special benefits that it had realized from depreciation of the currency required rectification.

With agriculture (including forestry, gardening, stock breeding, vine-growing, and fisheries) excluded from the charge, the Committee fixed the proposed burden on the remaining industries of Germany at a capital sum of 1¼ billion dollars, or $75,000,000 a year. All things considered, this was an extremely moderate charge. Probably few informed persons would be inclined to deny that industry could easily have afforded more. On the other hand, as a practical matter, it is doubtful whether any substantially larger charge could have been made effective. The industrialists had to be reckoned with as a factor in the ratification of the plan by the German government, and there were limits beyond which that powerful group could not be induced to go. Moreover, the charge on the railroads would itself result in an indirect burden on industry, and the two together constituted a very respectable figure.

There were excellent reasons why the combined charge should in large part be effected through the railway bonds. The railway charge would lie on distribution, midway between the producer and the consumer. Some of the charge would be borne by both. As a burden on the consumer, it was easily to be justified as being in replacement of the bond interest element in transportation costs which had been eliminated by inflation. As a burden on industry, the railway charge was more remote than the direct industrial mortgage charge and thus some-

what more removed from the possibility of attack by the industrialists.

Moreover, the charge laid on the railways represented the creation of an investment security of a more familiar type, which would be correspondingly easier to sell on the world investment markets when the appropriate time for such action should arrive. The industrial bonds, on the other hand, were less compact and manageable. They were based on a blanket mortgage on industry as a whole, supported by several thousand individual mortgages in the hands of a trustee. Thus, while ample physical security underlay them, innumerably more parties directly at interest were involved. The advantage of a broad basis which they enjoyed was offset by the difficulties of having to deal with a numerous class of debtors. As investment securities, the industrial bonds marked a somewhat new and untried departure.

With the exception of the primary food industries that have been named above, all industrial and trading concerns of more than $12,500 capital, including mines, shipping concerns and tramways, were made subject to the mortgage, and other concerns of more than $5,000 capital, while not so subject, are required by law to contribute toward the annual charge. The latter class includes banks, insurance companies, cafés, hotels, boarding houses, and commercial concerns. The major allocation of the blanket charge is governed by a provision of

law that at least 20 per cent. shall be borne by iron mining and iron and steel manufacturing, 17 per cent. by the machine and electrical industry, including the generation of electric power, 8 per cent. by the chemical industry, and 7 per cent. by the textile industry. The allocation of the remaining 48 per cent. is not specified.

Within its group, each concern takes its share of the charge on the basis of its working capital (*betriebsvermögen*) as determined for the tax on real and personal property (*vermögenssteuer*). In his report for 1925, the Allied Trustee for Industrial Debentures (Bernardino Nogara of Italy) stated that the total working capital of the concerns affected by the law, according to official estimates, was approximately 8 billion dollars. The annual charge, therefore, represented somewhat less than 1 per cent. of the capital. This burden the trustee estimated would be reduced about one third by extension of the charge to other classes of industry —at August 31, 1926, 53,397 concerns were liable to the charge.

The creation of an issue of first-mortgage railway bonds amounting to $2\frac{3}{4}$ billion dollars and carrying an annual charge of $165,000,000 ranks as one of the Committee's most important and striking achievements. As an effective instrument of reparation finance and, potentially, of investment finance, these bonds have unique character. The perfect adaptability of the railway properties to

the creation of such an instrument was viewed by all the members of the Committee with immense satisfaction. By the business men members it was regarded with something approaching enthusiasm. The great railway system of Germany stood out of the dreary morass of the reparation problem as a colossal objective fact on which business men could build with confidence.

About 33,000 of the 35,000 miles of railway lines in Germany were operated by the state governments. It was these government-owned lines with which the reparation project was concerned. With the assistance of a British and a French expert, the Committee made a careful investigation of the subject. They found a magnificent property, its equipment "modern and fully up to the level of the latest improvements in railway technique."

On a conservative estimate, the railways were worth 6½ billion dollars, and owing to the depreciation of the mark they were practically free from debt. The components of the system before the war had carried an annual debt charge of about $125,000,000. The annual gross profits out of which this charge had been met were about $250,000,000, in spite of the fact that large expenditures had been charged to maintenance which, in the Committee's opinion, might properly have been charged to capital account. Since the world began, no single property of such magnitude, physical excellence, and

proved earning power had ever been free for the imposition of a first mortgage.

Since the Armistice, the system had been operated at a loss, involving heavy charges on the German budget. It had been "enormously overstaffed" and "extravagant capital expenditures" had been incurred, "for which the official excuse is that construction was largely undertaken to ward off unemployment." But the Committee was convinced that, under proper management, under unified control, and with a proper tariff policy, the railways could without difficulty earn a fair return upon a capital value of 6½ billion dollars.

This improvement in earnings the Committee did not contemplate would be made at the expense of the German people by increasing passenger fares or freight rates. In their opinion, it could be substantially accomplished by more economical administration. Such economies the Committee was careful to point out would not imply the payment of inadequate wages to employees. They would be effected through the discontinuance of wasteful expenditure. Increased earnings would also be shown by eliminating from the operating and maintenance accounts those expenditures which were more properly chargeable to capital account. The Committee believed, however, that, so long as the railways were under government control, it would be useless to expect anything

approaching the full measure of possible improvement. "The whole spirit of the government's ownership in the past has been directed to running the railways primarily in the interest of German industry and only secondarily as a revenue-producing concern." They were of the opinion that a complete break with the traditions of government operation was essential.

As finally adopted and embodied in the German law, the railway plan provided for the operation of the railways by a joint stock company, under a concession running for forty years. The $6\frac{1}{2}$ billion dollars of capital value of the properties was represented by (1) $3\frac{1}{4}$ billion dollars in common shares, held by the German government, (2) one half billion dollars in preference shares (of which 75 per cent. were to be sold to the public to finance capital expenditure, and 25 per cent. sold for the benefit of the German budget), and (3) $2\frac{3}{4}$ billion dollars of first-mortgage bonds, guaranteed by the German government and issued to a trustee representing Germany's reparation creditors. The service of these bonds, including 5 per cent. interest and a charge of 1 per cent. per annum for sinking fund, represents less than 3 per cent. of the capital cost of the railways—"a very modest charge on the capital investment," as the Committee pointed out, compared with that in many countries.

As contemplated by the plan, the management

of the railways is in practice left in German hands. Nine of the eighteen directors of the new company are chosen by the German government and the private holders of preference shares. The other nine are appointed by the Allied trustee of the bonds.[1] Five of the latter, however, may be and are Germans. The chairman of the Board (C. F. Von Siemens) and the general manager must be Germans. The plan contemplates that the government shall have such control over the tariffs and service as may be necessary to prevent discrimination and to protect the public without impairing the ability of the company to earn a fair and reasonable return on its capital cost.

A railway commissioner, at present Gaston Leverve of France, represents the Allies. Normally, he has no operating authority. He has the right to inspect any and all parts of the system, to receive full reports of operations, and to examine all proposals for non-routine expenditures, changes in tariffs, and the granting of special rates. But, in the event of a default on the bonds, he has the right to veto expenditures, to increase tariffs, and to remove the general manager. Should the default continue six months, these rights are expanded to complete operating powers and authority to sell surplus property. In such circumstances, the Commissioner, with the consent of an arbitrator appointed by the president of the Court of International

[1]At present former Premier Delacroix of Belgium.

Justice, may also lease the railways in whole or in part for the purpose of assuring the service of the reparation bonds.[1]

The Committee's railway scheme has been an unqualified success. In spite of the difficulties of the early period, the railways, for the first fourteen months of operation ended December 31, 1925, earned an operating profit of $205,000,000, of which $100,000,000 (the full amount required for this initial period) was appropriated to the service of the bonds. After setting aside reserves, about $38,000,000 was carried to surplus. The earnings for 1926 were $215,000,000, out of which were met the charges for the reparation bonds, amounting to $143,500,000 preference dividends of $10,000,000, and reserve appropriations, leaving a surplus for the year of $42,000,000.

Along with the subject of raising reparation funds from industry and the railways, the Committee considered the possibilities of revenue from regular taxation. In this aspect of its work, the Committee examined the taxation system in general and several past and prospective budgets in particular. It could not well do less than that if it was to arrive at defensible general conclusions as to the German tax burdens. But it could not well do much more. The Committee was clear that an attempt to construct a detailed budget for the

---

[1]Article 24 of the Statutes of the Railway Company enacted by the German law of August 30, 1924.

German government would exceed the natural limits of its mission.

Such an attempt would have been futile. "The taxation of each large nation to-day," said the Committee in its report, "is the product of many factors, including its historical evolution, its economic conditions, its political ideas, its constitutional framework, and its social psychology. What is a good system for one country may be quite unacceptable for another. Even though the same elements may exist in two systems, the importance played by those several elements in the whole may be quite different. If a similar total burden is being raised in two countries, it is almost certain that the manner in which it is being spread over the community and the particular devices adopted to raise it will be very different. . . . The Committee would desire to avoid being dogmatic as to the way in which a given sum shall be raised by the German government. Having come to the conclusion that a given burden can be borne, it is for Germany to suit her own conditions in prescribing the ways in which it shall be obtained."

However, the Committee did offer certain suggestions. It seemed to it that indirect taxes were "unduly low," taxes on motor transport "too low," and on estates "extraordinarily low," and that the turnover tax (of $2\frac{1}{2}$ per cent.) was somewhat high.[1]

[1]Since reduced in successive stages to $\frac{3}{4}$ of 1 per cent. in 1926-1927.—Report of Agent General, June 10, 1927.

Its major criticisms of the fiscal system dealt with two subjects of first importance—the income tax and the fiscal relations between the Reich and the States and Communes.

The income tax, the Committee said, was inadequate. The wealthier classes had not been reached properly, "either to an extent which the taxation of the working classes would justify or to an extent comparable with the burdens upon the wealthier classes in other countries." In a total estimated budget of $1,300,000,000 for the year 1924–1925 (ending March 31, 1925), the Committee drew attention to an estimate of $336,000,000 for taxes on wages and income, of which 64 per cent. represented taxes on wages.[1]

With respect to its second major criticism, the Committee dwelt on the unsatisfactory results of the fiscal centralization in Germany which had followed the revolution of 1918. Under the new system, the Reich administers taxes formerly administered by the States and contributes largely to the budgetary needs of the latter. The Committee pointed out that while the States discharge many of the functions of government, there is no clear principle connecting their resources with their obligations. "When in difficulties," the Committee said, "they press the Reich for larger subventions

[1]The actual receipts later proved to be $553,000,000, of which 60 per cent. were taxes on wages. For 1925–1926, the results were similar, but in 1926–1927, out of a similar return, taxes on wages accounted for about 50 per cent.

(as percentages of the yield of taxation) just as in turn the needy Communes press the State for greater financial aid." The Committee was clear that "in the near future, the German government must take steps to put the relations between the Reich and its component parts on a regular basis which shall insure that the latter are not a constant drain upon Federal resources. . . ." The Committee's recommendations have not yet borne fruit. This feature of the German fiscal system is still the football of politics.[1]

The problem of establishing a fair and proper charge on Germany was a dual one. It had its internal and its external aspects, and in both fields a highly complex set of facts had to be digested and a highly difficult set of conditions mastered. The Committee had to determine how the charge was to be laid internally and, having regard to the burdens of the Allies, how much it should be in all. By outlining the scheme for industrial debentures and railway bonds, and by conducting a general survey of the system of taxation, the Committee

[1]About one third of the revenues of the Reich are now turned over to the States, these contributions being calculated by the use of percentages applied to the proceeds of the various categories of taxes. No general review of the system has as yet been made, and S. Parker Gilbert in his reports as Agent General has repeatedly pointed out the extremely unsatisfactory situation of the whole matter. In his report of June 10, 1927, he summarizes the "fundamental objections of principle" to the present system as follows: "First, the Reich under this system divests itself automatically of a large share of its principal taxes. . . . Second, the payments to the states and communes . . . are made without regard to their financial condition and requirements. . . . Third, the whole tendency of the present system is to confuse the responsibility for taxation. . . ."

cleared the ground for its major effort. The final test of its work would lie in the fixing of a schedule of reparation payments. To lay an equitable burden on Germany as a whole was the final, all-inclusive problem of reparations.

In its report on this subject the Committee went back to first principles—morally and historically. It stood on the "simple principle of justice," which had been written into the much-abused Treaty of Versailles, that the German people should be placed under a burden of taxation at least as heavy as that borne by the Allies. For four years, while the controversy had raged over international transfers, over the cancellation of the C bonds as a means of restoring Germany's credit, and over the occupation of the Ruhr, that principle had been lost from view. The Committee restored it as the one foundation upon which a common European sentiment could be built.

This principle the Committee termed the principle of the "commensurate burden." They reported that they found this conception "exceedingly difficult to translate into quantitative measurement as a basis for practical action." But they believed that, in the charge upon which agreement was finally reached, effect was given to that principle "in the fairest interpretation and application of [it] which is practicable."

In the expression of these sentiments the Committee, obviously, was unanimous. But as to the

processes which bridged the gap between acceptance of the principle of equity and the practical application of the principle to the problem in hand, the report bore unmistakable testimony to a serious internal clash of opinion. Two contradictory lines of thought ran through the report, without being reconciled.

The tenor of one of these ideas was that the burden of an internal debt was not comparable with the burden of an external debt. As between two apparently equal national tax burdens, it was argued, an internal burden has ameliorating features which are lacking in the case of an external burden. This was the familiar English doctrine that, "in the economic sense," an internal debt is no burden at all. The opposite line of reasoning was succinctly contained in the statement that to the taxpayer "a tax is a tax, whether the ultimate destination is the payment of a war debt due to fellow citizens or to foreigners."

Here, cropping out in the Dawes report, was the old irrepressible conflict between the economist school and the taxpayer school. By which one was the Committee guided in fixing the burden to be laid on Germany? It is obviously impossible that both of two contradictory lines of reasoning, which would arrive at widely differing results, could have been followed. The Committee arrived at an agreement, but it did not define its basis. We shall return in the next chapter to an examination of the evi-

dence which throws light on that question. Here let us look at the terms of the settlement.

The Committee agreed that Germany should make a fixed annual payment in each standard year of $625,000,000. These payments were to run for a considerable period of years, but no definite term was stated. It was further provided that this annual payment should cover all obligations of Germany to the Allied and Associated powers for costs and charges arising out of the war, including, among other things, the costs of the armies of occupation and the cost of administering the plan. Under the provisions of the plan, the standard annuity will commence in the fifth year which runs from September 1, 1928, to August 31, 1929.[1]

Half of the standard annuity of $625,000,000—$312,500,000—is to be contributed by the ordinary budget, specifically secured by the revenues from

[1]The details of the schedule of payments for the first four years are as follows:

First year, 1924–1925, total $250,000,000, including $200,000,000 from the external loan, and $50,000,000 part of the interest on the railway bonds.

Second year, 1925–1926, total payment $305,000,000, including $62,500,000 from sale of railway preference shares (actually purchased by the German government and not yet sold to the public), $148,750,000, interest on railway bonds (including $32,500,000 from the previous year), $62,500,000 transport tax, and $31,250,000, interest on industrial bonds.

Third year, 1926–1927, total $375,000,000, including $102,500,000 from the budget, $137,500,000 interest on railway bonds, $72,500,000 transport tax, and $62,500,000 interest on industrial bonds. (The plan fixed the third annuity at $300,000,000. It provided, however, for two contingent supplementary contributions payable from the budget in the fourth and fifth annuity years, amounting in the aggregate to $125,000,000. By an agreement between the Reparation Commission and the German government, September 8, 1926, the two contingent supplementary contributions were replaced by a single definite payment of $75,000,000 to be made during the third year.)

Fourth year, 1927–1928, total $437,500,000, including $125,000,000 from the budget and other payments as in the fifth or standard year.

customs and from the taxes on alcohol, tobacco, beer, and sugar.[1] A little more than one quarter, $165,000,000, is to be contributed by the railways as interest and sinking-fund payments on bonds, and somewhat less than an eighth each by a transport tax in the amount of $72,500,000 and by industry in the amount of $75,000,000, the latter paid as interest and sinking fund on the industrial mortgage bonds.

The plan provided that, in addition to the fixed annuity, there should be paid annually, commencing in the year 1929–1930, a supplementary sum dependent in amount on economic conditions in Germany. The annual determination of this supplementary sum is to be based on the average increase over certain standard years shown by six sets of representative statistics which make up the Committee's so-called "Index of Prosperity." The six component indices are: (1) Exports and imports together; (2) budget receipts and expenditures together, including those of the states of Prussia, Saxony, and Bavaria, and excluding Peace Treaty payments from both sides; (3) railway traffic, by weight; (4) value of consumption of sugar, tobacco, beer, and alcohol; (5) population, and (6) coal consumption per capita.

[1]These assigned revenues are controlled by an Allied commissioner for controlled revenues, at present Sir Andrew McFadyean, former general secretary of the Reparation Commission and general secretary of the Dawes Committee. Through his hands the revenues are repaid to the German government as the reparation annuity is paid to the Agent General from the sources upon which it is levied under the plan.

For the five years commencing September 1, 1929, the average percentage increase shall be applied to the sum of $312,500,000 to give the supplement for the year; thereafter to $625,000,000.[1] In the event of the index in any year producing as a supplement a minus quantity, the fixed annuity payment will continue to be made, but subsequent supplementary payments will be decreased accordingly.

The scheme for supplementary payments rests on the Committee's recognition of "both the necessity and the justice of maintaining the principle embodied in the Treaty that Germany's payments should increase with what may prove to be the increase in her future capacity." The index is on a broad basis, ensuring as well as possible a fair composite reflection of the general state of economic health of the country. The practical effect of it is problematical. Should it produce a large supplementary payment, it may well be that the justification of it on equitable grounds will present a new and acute issue of the reparation problem.

---

[1] "In computing the base, the average statistics for the three years, 1927, 1928, 1929, shall be taken for budget receipts and expenditures, for population and for coal consumption per capita, and for the six years 1912 and 1913, 1926, 1927, 1928, and 1929 for the other categories (after appropriate adjustments for the difference in population and the altered gold values to make the two earlier years comparable with the three later years in this respect). The percentage change for each of these six groups, compared with the base, shall be separately computed, and an arithmetical average of the six percentage results taken as the index. . . . For the year 1929–1930, the computation of the supplement shall be made after the end of that year by comparing the statistics of 1929 itself with the index base."—Dawes Plan, Annex 2.

We need not, however, now speculate on that possibility. One step at a time, if each step be taken on firm ground, is rapid enough progress toward the liquidation of the reparation problem. It is neither necessary nor possible at this time to determine the effects of the sliding scale established by the prosperity index.

It is, however, distinctly the part of wisdom to attempt to measure the burden imposed by the fixed annuity. What capital sum does it represent, what does the carrying of that sum imply in terms of German per-capita income, and how does that burden compare with the burdens of the Allies? The first one of those questions we shall attempt to answer in this chapter.

Most of us are familiar with the fact that there are two equivalent forms in which a debt may be stated. One form is that of a capital sum, upon which, until it is paid, interest charges are to run. The other form is that of a fixed annuity which is made up of the interest charge and an annual instalment toward repayment of the capital sum.[1]

The translation from one form to another depends on the period which the debt has to run.

---

[1]A fixed annuity may be considered alternatively as consisting (a) of interest payments of equal amounts each year calculated on the full amount of the debt, plus instalment payments of equal amounts each year, sufficient when placed at compound interest to amount, at the end of the period, to the capital sum, or (b) of interest payments of decreasing amounts (i.e., on a decreasing principal consisting of the original sum less instalments) plus instalment payments of increasing amounts totalling, without interest, the exact amount of the principal.

The two formulæ come to the same thing.

Obviously, a debt fixed as a capital sum due in ten years will require a larger annuity to discharge it than a debt due in twenty years; for that part of the annual payment which "sinks" the capital will have to be larger. On the other hand, a debt fixed as an annuity running ten years will be the equivalent of a smaller capital sum than one running twenty years, for the part which repays the capital will accumulate over the shorter period to a smaller total amount. The capital sum calculated as the equivalent of an annuity, known as the "present value" of the annuity, is the amount which would have to be put out to-day in order to procure an annual return, including interest earnings and capital repayment, of the stated amount for the stated period.

For purposes of comparison of national debt burdens, the present value of a series of payments —the capital sum form—expresses the obligation in terms of the only common denominator. If there were no indications in the Committee's report as to the intended duration of the annuities, it would be impossible, except on a merely year-to-year basis, to form any opinion as to the real measure of the burden on Germany and the relative weight of the resulting debt burdens of Germany and the Allies. Such an indication, however, is to be found in the report; and nowhere was the statesmanship of the Committee more impressively displayed than in the handling of this difficult subject.

British financial opinion held that the Committee had been placed in a hopeless dilemma by the necessity of creating a proper credit background for Germany in the foreign investment market while France held out against a definite cancellation of the major part of the original reparation debt. The Committee found a way out. It expressed the view that the return of confidence in Germany and abroad upon which financial stabilization depended could be attained only by a settlement giving assurance that for "a considerable period neither [Germany's] finances nor its foreign relations will be endangered by renewed disputes." No definite term of years was stated, nor was cancellation mentioned. But, in amplifying this statement of principle, the Committee employed language which has the result of fixing with some precision the term of the annuities and, without much doubt, of putting the greater part of the Treaty debt to sleep in perpetuity.

The Committee defined the term during which the affairs of Germany should not be disturbed by a renewal of controversy by explaining that it was "thinking primarily of the period which lenders and investors whose money is required as a part of our scheme will have in mind." In this connection, it mentioned specifically the External Loan, the period of which, as subsequently fixed, was twenty-five years, i.e., until 1949.

Now, as the report of the Dawes Committee was

freely accepted by Germany and the Allied powers and embodied in the Agreement of London, its language has become the basis of contractual obligations between the parties and constitutes their united guarantee to the investing public of the world at large.

It seems plain that a guarantee has been given that there shall be no serious dispute regarding the terms of the reparation settlement during the twenty-five years ending in 1949. It seems equally plain that two definite obligations were created: An obligation upon Germany to pay the full annuities to the Agent General of the Allies (subject to suspension by the Transfer Committee) until 1949, unless downward revision can be obtained without serious dispute; and an obligation on the Allies to accept such payments in full satisfaction of all accruing claims on Germany for costs or charges arising out of the war, unless an upward revision can be obtained without serious dispute.

Germany and the Allies have, in effect, undertaken that the annuities shall be stabilized until 1949, or if a final settlement is brought about before that date, that the fair equivalent of their total, in one form or another, shall be paid and received. That part of the annuities, however, which is derived from the railway and industrial bonds, has been separately guaranteed by the German government, in the instruments themselves, to run an additional fifteen years, i. e., to

1964, when the bonds will be fully retired by operation of sinking fund.

It is therefore reasonably clear that, through the adoption of the Dawes Plan by the governments concerned, an annuity of $625,000,000 (plus or minus a prosperity adjustment) was guaranteed to run for twenty-five years, and an annuity of $240,000,000 a year was separately guaranteed to run for fifteen years longer.[1] It seems scarcely within the bounds of possibility that any extension of these payments will ever be negotiated.[2] What, then, was the capital amount of the settlement?

The rate of interest specified by the Treaty of Versailles for the reparation debt was 5 per cent. We have, as the basis of our calculation of the capital sum, the payment until 1949 of the standard annuity of $625,000,000 (with the four smaller commencing annuities) and the annual payment of $240,000,000 (the part relative to the railway and industrial bonds) for an additional fifteen years. These payments, taken together, consist of

---

[1]In the event that before 1949 some of the railway or industrial bonds are sold to the public, the claim might conceivably be set up that by this injection of investors' money through an issue running until 1964, the entire annuity would come under the guarantee which the signatories of the London Agreement made to the investing public and that that guarantee would automatically be extended to 1964. The practical answer to this is that, before the bonds could be publicly negotiated, it is likely that amendments in them providing for their payment in foreign currencies would be required by bankers, and such amendments would require the consent of the German government.

[2]It is, of course, possible that an increase in the fixed annuity or an extension of its period might be negotiated to take the place of the supplementary payment arising from operation of the prosperity index.

interest at 5 per cent. and sinking-fund payments on a capital sum of about 8 billion dollars, which would be fully retired at the end.

If, however, we may assume that the Allied governments, over a period of years, will be able to borrow money at 4 per cent., the value of the payments made by Germany should be calculated on the basis of their consisting of interest at 4 per cent., plus sinking-fund payments. The reasoning is this: If the Allied treasuries were paying 4 per cent. on their public debt, that part of it which the annuity received from Germany would take care of without burden on the Allied taxpayer would be the capital sum on which $625,000,000 would be interest at 4 per cent. plus sinking-fund instalment. That capital sum would be about nine billion dollars.

Excluding any figures to cover the prosperity adjustment, for which there is at present no basis for an estimate, we may regard 9 billion dollars as the approximate amount of the settlement. Stated in capital form, this is the amount fixed by the Dawes Committee as Germany's equitable contribution to the reconstruction of Europe.[1]

[1]The settlement of 9 billion dollars is $3\frac{1}{2}$ billion dollars less than the nominal value of the old A and B reparation bonds. The share of England in it is about 2 billion dollars, and the share of France is about 4.8 billion dollars.

Subject to certain prior charges for army costs, etc. (including an annuity to the United States of about $13,750,000 a year for eighteen years in satisfaction, without interest, of a claim for army of occupation costs amounting to about $250,000,000), the distribution of reparations among the Allied and Associated powers, as fixed by interallied agreement, January 14, 1925, is as follows: United States, 2.25 per cent., France, 53.235 per cent., Great Britain,

It was suggested a few pages back that three questions relative to the charge laid upon Germany by the Dawes Plan are of importance to students of the plan: What was the real amount of the charge? What burden does it place on the average per-capita income of the Germans? And is it a fair burden in comparison with those of the Allies? We have dealt with the first of these questions. The other two involve an attempt to measure the weight of the charge as well as the weight of the debt burdens of the English and the French, after giving effect to the relief afforded them by the payment of reparations. We shall deal with these questions in the next chapter.

22.522 per cent., Italy, 9.775 per cent., Belgium, 4.399 per cent., Serbia, 4.887 per cent.; other powers, 2.932 per cent. The reparation annuity of the United States (2.25 per cent.) is limited to 11¼ million dollars a year. This payment applies toward the American reparation claims which, as fixed by a joint German-American commission, it is understood will amount to about $250,000,000 and which it appears that the United States government intends to recover without interest.

Assuming that the United States receives a total of $250,000,000 in reparations by means of an annuity of 11¼ millions running for twenty-two years, the present value of such a series of payments at 4 per cent. is about $165,000,000. The difference between this amount and $250,000,000, the amount of the claims, represents the loss of interest which would be sustained by the United States government if it borrowed $250,000,000 at the present time for the purpose of paying off the claims of its citizens; or, alternatively, it represents the loss of interest to the claimants if they are to be paid off only *pari passu* with the German payments.

CHAPTER IX

THE BURDEN OF THE PLAN

THE Dawes Committee expressed the opinion that the burden imposed on Germany by the settlement was a fair one, but they did not give their reasons.

The honeymoon stage of the plan is fast passing. The rumblings of criticism and dissatisfaction in Germany are growing louder month by month. It would be as well if those who support the plan on its record as the greatest tranquillizing instrument of modern times would give attention to the question on which it must stand or fall. That question is, is it a fair settlement?

On this subject, most of the friends of the Dawes Plan are as poorly documented as its enemies. This is an unfortunate circumstance. For it is easier to shake public confidence in an institution by unfounded criticism than it is to maintain it by meaningless expressions of approval which lack a backbone of facts. More than that, the plan unquestionably places a heavy burden on Germany. The Germans are human. They are bound to complain. And when the complaints become insistent,

what answer is to be given them? If the burden is a fair one the fact must reasonably be demonstrated.

It is a highly complicated question. It is full of pitfalls. But there are certain principles to guide us toward an answer. We must determine, as nearly as may be, what the debt burdens of the various parties to the settlement amount to in dollars per capita and what they amount to relatively to income.

Before we can determine what the public debts of Germany, France, and England amount to in dollars per capita, however, we must deal with two matters referred to in the preceding chapter which raise the question of mathematical interpretation or measurement of the amounts of the debts as they stand. The external-internal debt controversy is one of these matters, and inflation is the other.

We have already noted that the old conflict between the taxpayer and the economist schools of thought cropped out in that part of the Committee's report which dealt with the fixing of the amount of the reparation annuity. The conflict centred around the question whether an internal debt, such as the debts carried by the Allies, is comparable in weight, dollar for dollar, with an external debt such as Germany carries as a reparation charge.

It is clear that the taxpayer school was represented in the Committee, for in one place, as we

have already noted, the report says that "a tax is a tax, whether the ultimate destination is the payment of a war debt due to fellow citizens or to foreigners."

On the other hand, if we did not know that there were professional economists on the Committee, we could be reasonably assured of the fact from the inclusion in the report of a familiar economic doctrine. The report says that the Allied debt charge is "to a considerable extent in the nature of a redistribution of annual wealth among the members of each nation and has little relation to the problem of a national burden in the collective sense." It goes even further. It says that "it is difficult to bring such a task [i.e., the task of paying an internal debt] into direct relation with the problem of reparations."

The two points of view are diametrically opposed. From the second of them, the conclusion is to be drawn that in comparing debts an allowance should be made to Germany on account of the external character of the reparation debt. The question arises, did the Committee make such an allowance to Germany, or was it, on the contrary, guided by the assumption that a tax is a tax, whatever its destination. The Committee does not tell us.

Though certain features of the internal arrangement of the report and the emphasis given to its various parts suggest that the taxpayer school in

the Committee agreed to the inclusion of a statement of the opposite doctrine merely to keep peace in the family, the fact is that the dictum of the economists carries the weight of the whole Committee behind it and is capable of being cited as an authoritative reason for upsetting the settlement. Logically, it leaves the implication that if the reparation charge placed on Germany by the Committee was arrived at by any ordinary known principles of debt comparison, the charge was in reality too heavy. Nothing could be more unfortunate. The international transfer bugaboo introduced into the plan the suggestion of impracticality; the generality regarding the problem of "a national burden in the collective sense" furnishes the rallying point for a cry of injustice.

Like certain assertions regarding transfers which we have already examined, the theory that the burden of an internal debt is not a real national burden is stated in the report quite baldly, as if it were a truism. The only explanation vouchsafed is somewhat cryptic to the casual reader: "The interest paid [on an internal debt] [1] forms a part of the national income, [2] as it is expended it provides profits and a stimulus for internal trade and so increases further the income of the country, and [3] in particular it is itself an important source of internal taxation." The Committee adds: "A payment in respect of a debt to foreigners has no comparable advantages to the country making it."

Interpreted, this means that a country with an internal debt has a larger national income (i.e., total or average earnings of its citizens) than it would have if its debt were an external debt, and therefore the burden of the internal debt, expressed as a percentage of income, would be lighter than the burden of an external debt. If we may further paraphrase and expand this dictum, the reason for the national income being larger when the debt is an internal one is said to be that the domestic bondholders receive the interest paid by the taxpayers, while, in the case of an external debt, foreign bondholders receive it.

This is extremely plausible. In fact, it sounds absolutely convincing. But did the economists really think the thing through?

Let us pick this doctrine to pieces a bit. Let us imagine that the government of the island of Atlantis in the year 1913, or any other year, incurred an internal debt of a million ducats. On this debt the taxpayers paid the bondholders 4 per cent. interest or 40,000 ducats a year. This interest received by the bondholders was a part of the national income. So far we follow the economists.

Now, though the connection may at first seem remote, let us ask, what was this million ducats in reality, and where did it come from when it was borrowed? The answer is, it was free capital in the hands of citizens. What is capital? It is tangible wealth produced and not consumed, i.e., savings.

Now let us suppose that, during 1913, the year in which the government loan was made, the total amount of production in the country which was saved over consumption and rendered available for investment was 5 million ducats. How was this invested? Industry presumably took four million and the government one million. Assume for the sake of simplicity that industrial investments were all in bonds and they all paid 4 per cent. interest. Then, on the total capital invested during that year, i.e., 5 million ducats, bondholders received 200,000 ducats in interest, of which 40,000 was the interest already mentioned as paid by the government, and 160,000 was paid by industry. Then that part of the national income represented by interest earned on the free capital produced and invested during 1913 was 200,000 ducats.

Let us now assume that the government of Atlantis did not borrow any money at all in 1913. Let us suppose, instead, that a judgment of a million ducats was awarded against it in favour of the government of Oceanica for damages to the latter's fishing rights in the Sargasso Sea. The government of Atlantis assumes this obligation, and as a result it has an external debt of a million ducats. The interest charges on this debt, amounting to 40,000 ducats a year, are to be raised by taxation and paid to a representative of Oceanica stationed in Atlantis for the purpose of arranging the transfers of funds to his home government.

What is the result of this situation compared with the one previously assumed? The amount raised by taxation in Atlantis is the same as under the first assumption regarding an internal debt, i.e., 40,000 ducats. The amount of capital available for investment during the year is, of course, the same, for we are assuming the same year in the two cases, i.e., there are 5 million ducats of new capital for investment. But instead of one million being loaned to the government and 4 millions to industry, all 5 millions are loaned to industry. The interest income received by capitalists from the investment is still 200,000 ducats, the same as under the prior assumption.

This, we believe, answers number one of the Committee's three explanatory statements, by demonstrating that the same amount of interest which would form part of the national income if there were an internal debt forms part of the national income when there is an external debt. This covers the question of interest as a part of national income up to the point where the interest is received by the capitalists.

Now, beyond that point, what is the case? Statement number two of the Committee is that interest received from the government by holders of internal government bonds provides, when it is expended by the capitalists, a stimulus to internal trade and so increases further the income of the country. Here we have an assumption that the

possession, or rather the use, of free purchasing power stimulates trade, and that an increase in trade means an increase in national income. This may be admitted. If a demand is effective, i.e., if a would-be purchaser has the price, someone will produce the article which will satisfy his demand. But it follows from our discussion of interest that the same conditions would apply if the country had an external debt. Take Atlantis again. The same amount of purchasing power fell into the hands of capitalists under both hypotheses, and thus the same amount was free for expenditure and stimulation of trade. Thus, the implication of any advantage in this respect to a country with an internal debt breaks down.[1]

The supposed advantage enjoyed by France over Germany, therefore, must arise, if it arises at all,

[1]A variation of the "stimulation" argument of the economists has to do with the payments made by the respective governments for interest on debt. Let us see whether that has any merit.

The French government pays francs to the holder of government bonds, who expends them for goods for personal consumption or invests them in enterprises seeking new capital or, by purchasing existing securities, releases an equivalent amount of funds to the seller for use as new capital. Thus, whether the person who cashes government coupons uses his purchasing power for consumption purposes or for investment, he stimulates business in France.

Now, in Germany, what is the case? The German government pays marks to the Agent General, who expends them for goods for delivery to the Allies; or, by purchasing foreign exchange, he makes the marks available for productive use in Germany. Under the latter alternative, it might be objected that, in case the sellers of the foreign currencies are Germans, the exchange of funds does not add to the total available capital of German citizens. Naturally not, but the transaction furnishes them with funds which have purchasing power inside Germany, in exchange for assets which have purchasing power outside Germany. Foreign currencies, if productively employed as such, cannot stimulate German business; they can stimulate only the business of foreign countries. In either case, then, whether the Agent General buys goods or foreign exchange, he furnishes a stimulus to business in Germany.

in connection with proposition number three, namely, that interest paid on an internal debt has the effect of being "an important source of internal taxation." In other words, the interest, when it reaches the coupon holder as income, is presumed to offer to the French government a target for fresh taxation, such as, either in size or suitability, is not available to the German government. But this is obviously not so. For it follows from our discussion of income that the same amount of taxpayers' income of precisely the same nature is available to each of the governments for taxation. Interest received by capitalists from loans to industry, as in Germany, is obviously as fair game for the tax collector as interest received by capitalists from loans to government, as in France.[1]

As already noted, the general conclusion in the Committee's report, argued from the three propositions just examined, was that an internal debt "has little relation to the problem of a national

[1]An example in figures: Assume country F with an internal debt of 3,000, and country G with an internal debt of 2,000 and an external debt to country F of 500. Assuming 10,000 capital loaned out by capitalists in each country: in country F, 3,000 is loaned to the government and 7,000 to industry; in country G, 2,000 is loaned to the government and 8,000 to industry; total income of capitalists in either case at 4 per cent. is 400. Tax burden for interest on debt in country F is 120, less 20 received by the government from country G, total 100 or 4 per cent. of 2,500; tax burden in country G is 80, plus 20 on public debt owing to country F, total 100, or 4 per cent. on 2,500.

These figures, of course, represent only the interest element in the problem of comparative income and tax burdens. They show that that element is not affected by the question of whether the debt is internal or external. In a complete picture, national income of all kinds would be taken into account, reduced to a per-capita figure, and the ratio to the latter of total per-capita taxation found. When that is determined as nearly as may be, the external debt of country G, representing the equalizing payment between the taxpayers of the two countries, would be adjusted accordingly.

burden in the collective sense." After examining the premises of this dictum, it seems fair to ask if taxation for the purpose of paying a national debt, whether it be internal or whether it be external, does not constitute a national burden, what is it precisely which does constitute one? The reply of the economists to this question, we suspect, would be that, in some way due to the behaviour of laws affecting the mechanics of exchange and the transfer of capital, the payment of an external debt involves a drain on the general economic strength of a country.

With deference to the economists on the Dawes Committee, we do not believe that such a reply will hold water. It arises out of the fundamental misconception that debtor countries in the world system settle their international balances by export of capital. The fact, of course, is that capital moves not *from* but *to* debtor countries, in obedience to the law of supply and demand applied to capital, and debtor countries settle their international balances by export of securities. There is no capital drain whatever on a debtor country. It is fed with capital by creditor countries. When it does commence to export capital, still in obedience to the law of supply and demand, it has then become a creditor country, and is putting to work abroad surplus capital not needed at home.

The only drain on Germany resulting from the payment of reparations is the drain on the German taxpayer. If the schedule of reparation payments

results in an equalization of his burden with that of the French taxpayer, without regard to the external or internal character of their obligations, the reparation problem as a case in equity has been solved. The implication that by such a settlement some additional burden "in a collective sense" is saddled upon the German nation is entirely meaningless.

We said that two matters had to be dealt with which raised the question of mathematical interpretation of the debts as they stand; one was the external-internal debt controversy, which we have just examined, and the other was inflation.

Inflation complicated the Committee's problem of equivalence of international burdens and made it highly controversial. If there had been no inflation and the German public debt had remained in force at its full value, the German internal-debt burden would have been much less per capita than the Allied burden. In those circumstances it would have been quite clear that a heavy charge on the Germans for reparations, based on a straight comparison of debts as they stood, was the proper equalizing factor. But the German public debt had, in fact, been cancelled by depreciation of the currency, and there were, in general, two diametrically opposed ideas as to the effect of this on the principle of the equalizing of international burdens.

It was a popular claim among the Allies that the German taxpayer, having been relieved of the burden of the public debt, was, in equity, liable to

a greater charge in the way of payments to the Allies, in order that the burden might be equalized. Obviously, this was wrong, since, by inflation, a charge had been laid upon the German nation for debt retirement in a lump sum in advance, the effect of which would be felt for many years by those numerous classes of the community upon whom the blow had fallen.

The opposite theory was that, by this lump sum capital assessment, a much higher tax burden had in effect been laid on the German people, which equitably relieved them from reparation payments. This idea also was untenable. It would be clearly seen to be so if the currencies of the Allied nations should fall and their internal debts should be wiped out. In such an event, by reason of their higher initial debts, a higher capital assessment would fall on the Allied middle classes than had fallen on the Germans; and the inequality would still have to be redressed by a reparation charge placed on Germany.

The same conclusion is demonstrable also by other reasoning: Assuming no violent depreciation of the Allied currencies, it would be a fact that, at the end of the normal period of retirement of public debt, the Allied taxpayers would have carried their debts to extinction through a protracted process of high taxation, higher on an average per annum over the whole period than the taxation sustained in the form of a single lump sum payment by the Germans on their smaller debt.

What conclusion is to be drawn? We have seen that a comparison of internal debts at the capital figures at which they stood after inflation would be meaningless. It would be grossly unfair to Germany, since it would ignore the capital burden of its debt thrown on the shoulders of its middle class in one lump sum. On the other hand, it would be meaningless to argue that the Allied middle classes, by reason of carrying only the interest charges and sinking-fund payments on their larger debts, were carrying a lighter burden in the long run than the Germans. For while the effects of inflation in Germany were wearing off, the Allied burdens would continue on a horizontal line.

The conclusion, we think, is clear. Looking at the debt problem as the problem of a generation, inflation had not, broadly speaking, affected it at all. The original public debts left by the war, calculated at their original figures before depreciation, furnished and still furnish the only true standard of comparison.

The debts, at their original figures, are measurably the constant factor in the reparation problem. This is so for the reason that debts redeemed on a large scale (either by inflation or by high taxation) remain a constant factor of depression in the affairs of numerous classes of citizens throughout the period in which the debts would ordinarily have been discharged by sinking-fund payments of normal magnitude. As a matter of fiscal mechanics, the

retirement or depreciation of debt gives relief to the public treasury, but in its economic and social aspects the burden of the debt remains. In every real sense, such debts are still alive. The figures of the colossal government borrowings of the decade which commenced in 1914 constitute the permanent bench mark of the reparation problem, as well as of interally debts. They mark the point from which, for a generation, stable standards of judgment on these problems may be developed.[1]

A comparison, based on this principle, of the debts of France, Germany, and England, as affected by the reparation settlement, is shown in the first three tables in the Appendix. The tables show a remarkable similarity between the debt burdens of Germany and France, while England appears to be considerably better off than either. The results may be summed up as follows:

Great Britain's debt, $711 per capita, is equivalent to 23.4 mos. pre-war income.

Germany's debt, $638 per capita, is equivalent to 34.9 mos. pre-war income.

France's debt, $813 per capita, is equivalent to 35.2 mos. pre-war income.[2]

---

[1]This proposition was put forward by the writer in his article on reparations signed "Alpha" in *Foreign Affairs* (N. Y.), September, 1923.

[2]The U. S. public debt, now standing at about 19 billion dollars, amounted at its high point in 1919 to 26.6 billion dollars or, on the basis of our present population, about $227 per capita. Assuming that we hold our allies to a repayment of about 7 billion dollars, the per-capita figure at the high point becomes $167. Our per-capita income, according to estimates of the National Industrial Conference Board (1927), is about $670. Without repayment of interally debt, our high-point debt burden equals four months' income; with repayment, about three months' income.

The processes on which these calculations rest are indicated in the tables and the notes accompanying them. The debts have been stated at figures as near their gold value when incurred as the difficulty of the subject permits. Certain assumptions have been necessary, and certain adjustments have been made in order to bring noncomparable figures on to a comparable basis. The debt figures have been carried back to a pre-war equivalent, by an adjustment based on the difference in pre-war and post-war price levels. The purpose of this is to be able to compare the debts with estimates of pre-war income, since satisfactory post-war estimates for Germany and France are not available.

This adjustment introduces into an already involved subject an element which may be regarded by some as unreal and theoretical. But is it so? Certainly the price differences and the complementary difference in the value of money are neither unreal nor theoretical. They are a familiar fact of everyday life, and the statistical method based on a recognition of it is a commonplace of modern statistical science. The most unsatisfactory feature lies not in the adjustment itself, but in the circumstance which requires it, viz., the necessity of using pre-war income estimates as indicative of relative conditions to-day. Admittedly, the results are imperfect. But our choice is between imperfection and nothing at all—between

theory, if one chooses to call it such, and unaided guess-work.

To what extent the Committee's findings were based on theory and to what extent on guesswork is an interesting question. From our analysis of the figures, the settlement appears to be a conspicuously fair one. From this analysis, it appears that, however the settlement was arrived at, its effect was to disregard one of the pleas advanced on behalf of Germany and to admit the other. In effect, the claim for preferential treatment because of the supposed disproportionate weight of an external debt was ignored, while the burden placed on the German people by inflation was taken into account.

The settlement was a composite opinion, or probably, more accurately, a compromise opinion of different minds, which worked in different ways and assigned different degrees of importance to the various factors. Unquestionably, these individual views each represented in considerable part a combination of theory and of guesswork. For beyond a certain point in a subject so complicated and obscure, theory and guesswork are all that human minds are able to bring to bear. If the minds are small minds, the result is futile. If they are large minds, with deep backgrounds of understanding and experience, the result is an achievement of the kind which some characterize as a triumph of statesmanship and which others call an example of

sound business judgment. We may, with reason, regard the settlement made by the Dawes Committee as such an achievement.

The story of the prolonged and dramatic episode which culminated in the agreement on the amount of the annuity has not been made public property. It is common knowledge, however, among all who were in close contact with reparations at the time, that the American members played a decisive part in this supreme test of the Committee's practical capacity. It is apparent that all concerned were thankful to be able to reach an agreement and were correspondingly disinclined to run unnecessary risks of upsetting it by trying to cross t's and dot i's. Such a conclusion may fairly be drawn from the fact that readers of the report are left in the dark as to the real basis of the figure. It is only from examination of facts not shown in the report that we conclude that the Committee as a whole rejected the theory that an internal debt has little relation to the problem of a national burden in the collective sense and that it maintained the principle that a tax is a tax, whatever its destination.

The final governing condition of the reparation settlement was the evacuation of the Ruhr. In the report of the Committee, this conception was expressed somewhat less bluntly than in the words just used, but no less clearly. Their whole report, the Committee stated, was based on the assump-

tion that the fiscal and economic unity of Germany would be restored.

Though they were careful to state that their terms of reference did not comprehend questions of military occupation, they felt it their duty to point out that their forecasts of Germany's ability to pay were "based on the assumption that economic activity will be unhampered and unaffected by any foreign organization other than the controls herein provided." The plan was "based on the assumption that existing measures, in so far as they hamper that activity, will be withdrawn or sufficiently modified so soon as Germany has put into execution the plan recommended, and that they will not be reimposed except in the case of flagrant failure to fulfill the conditions accepted by common agreement."

The Committee grasped this thorny part of the problem with great firmness, they had given high evidence of competency and good will, the plan promised well, and the French members were wise enough and courageous enough to make it unanimous. The purpose of the occupation had been fulfilled.

In the composite mind of the Committee there was no doubt that "if the economic and fiscal unity of the Reich is restored, if a stable currency is established, and if the budget is given temporary relief in Treaty payments, Germany should balance her budget from her own resources by a vigorous

internal effort, supported by the confidence which a general and stable settlement may be expected to give, and she should thereafter be able to maintain it in equilibrium, if the future charge for Treaty payments is determined by a method which assures that it will not exceed her capacity."

The Committee emphasized that "the performance of these commitments is of vital importance, not only for the countries having a claim on Germany, but also for Germany herself. It is, indeed, clear that a Germany whose economy had again become flourishing could not long resist a financial and economic crisis in the nations surrounding her. In order that the restoration of Germany may be definitive, the other nations must also return to the conditions requisite for their financial and economic existence, and must likewise be enabled to carry on the normal exchange of goods on which the general prosperity depends."

"The task would be hopeless," the Committee said, "if the present situation of Germany accurately reflected her potential capacity; the proceeds from Germany's national production could not, in that case, enable her both to meet the national needs and to insure the payment of her foreign debts. But Germany's growing and industrious population; her great technical skill; the wealth of her material resources; the development of her agri-

culture on progressive lines; her eminence in industrial science; all these factors enable us to be hopeful with regard to her future production. . . . Germany is . . . well equipped with resources; she possesses the means for exploiting them on a large scale; when the present credit shortage has been overcome, she will be able to resume a favoured position in the activity of the world where normal conditions of exchange are gradually being restored. Without undue optimism, it may be anticipated that Germany's production will enable her to satisfy her own requirements and raise the amounts contemplated in this plan for reparation obligations."

After three years, it is possible to say with considerable confidence that the views of the Committee regarding Germany's recuperative power were not too optimistic. Germany is recovering from the deflation crisis of 1924–1925, the currency is stable, taxes have been reduced, while revenues have been maintained and all reparation payments have been duly made.

It is true that budgetary expenditures have been increasing. In 1924–1925, a surplus of about $135,000,000 was realized, in 1925–1926 there was a deficit of $28,000,000, and in 1926–1927, one of $213,000,000, covered by borrowing. A deficit of similar size for next year is predicted, though revenues are expected to be higher. The estimated ex-

penditures amount to 2,282 million dollars, an increase over 1924–1925 of 477 millions.[1]

In the opinion of the Agent General, as expressed in his report of June 10, 1927, "the rising tide of government expenditures . . . requires the closest attention . . . . At the same time, it is clear that the essential stability of the German budget remains unimpaired, and that the problems presented by the budget should yield readily enough to a steady application of sound principles of budget-making."

That the reparation payments throw no inequitable burden on Germany, as compared with the burdens resting on France, England, Belgium, and Italy, is reasonably certain. That fact ought

[1]The following information is adapted from Mr. Gilbert's report of June 10, 1927:

Principal Classes of Expenditure—German Budget	*Millions of dollars* *Estimated 1927–1928*	*Increase over 1924–1925 (Decreases in italics)*
Payments to States and Communes . .	723	30
Army and Navy	175	60
Other General Administrative Expenses	435	135
Dawes Plan	208	208
Unemployment relief	145	136
Pensions (war and civil)	369	102
Revalorization of debt	89	89
Investments, loans, etc.	59	31
Internal charges arising out of the war	44	*240*
Other items	35	*74* (net)
Total Expenditures and Net Increase	2,282	477
Revenue	2,068	128
Deficit	214	349*

*Surplus in 1924-1925 was 135, the deficit of 214 indicated for 1927-1928 therefore represents a change for the worse of 349 from the 1924-1925 results.

to throw a revealing light on the familiar question whether the debt is within Germany's capacity to pay.

The term "capacity to pay" has acquired in the popular mind certain meanings which it does not possess. One of these is the conception of a scientifically determinable figure. This is, of course, absurd. There are no standards of national capacity to make sacrifices which would permit the determination of a figure within a range of more billions of dollars than the amount of the entire reparation debt.

The chief elements of capacity to pay are imponderable. It has no rigidity. Under the spur of a moral idea, it is infinitely expansible, as we learned during the war. Under the spur of such a moral idea as roused Hampden against the payment of ship money or Sam Adams against the Stamp Tax, capacity to pay may become nil. Nor, unfortunately, does the moral idea have to be a valid one in order to stimulate a nation to pour out its treasure without limit, or, on the other hand, to deny its just obligations. Ambition, fear, race prejudice, all travel under the cloak of a high patriotism. Who shall assess all the imponderables and say with precision what the capacity of a nation to pay amounts to in dollars and cents? Science may advise. But only statesmanship is entitled to hazard an opinion, and that opinion will be nothing more than a guess.

Capacity to pay, moreover, as a factor in the reparation problem, has no absolute application to Germany. It is all relative. The moral implication contained in the idea that the reparation debt may be beyond the capacity of the German taxpayer has no validity, if it contemplates saddling the Allied taxpayer with an intolerable burden. The idea that the "capacity of Germany to pay" is the governing factor in the reparation question is a mistake. The real reparation problem is whether France, England, Italy, and Belgium, as well as Germany, can weather the political and social strain of paying for the war without recurrent disorders of a distressing and ominous character. Germany is only part of this problem. The nations of Europe are all in the same boat together, and a leak at the bow is just as dangerous as a leak at the stern. Any strongly maintained plea for Germany amounting to a claim for her preferential treatment will constitute a serious threat to the peace of the world.

CHAPTER X

AN ESTIMATE OF THE PLAN AND ITS MAKERS

THE report of the Dawes Committee was rendered to the Reparation Commission April 9, 1924, not quite three months after its first meeting.

The Committee stated that they regarded the report as an indivisible whole. "It is not possible, in our opinion," they said, "to achieve any success by selecting certain of our recommendations for adoption and rejecting the others, and we would desire to accept no responsibility for the results of such a procedure nor for any undue delay in giving execution to our plan."

Two days later, the Reparation Commission approved the entire plan in principle, in so far as its authority lay, and on April 17th approved it definitely, and referred it to the Allied governments for their action. Meanwhile, the German government had expressed to the Commission the view that the report offered a practical basis for the rapid solution of the reparation problem and declared its willingness to collaborate in the execution of the plan. Within ten days' time, all of the principal

Allied governments had advised the Reparation Commission of their acceptance of the plan in principle.

It remained for the Allied and German governments and the Reparation Commission, whose nominal jurisdiction was to be preserved, to agree upon the multifarious details necessary for placing the plan in operation. There followed diplomatic conversations between the Allies, preliminary to an international conference. In the early part of these negotiations, particularly those between England and France, the part of mediator was played by Premier Theunis and Foreign Minister Hymans of Belgium. It soon became evident, however, that the British Premier, MacDonald, and the French Premier, Herriot (who on June 1st succeeded Poincaré), were determined, in the words of a joint communiqué issued by them on June 22d, "to meet the difficulties which beset their two countries, and, indeed, the whole world, by continuous coöperation."

It was in this spirit that on July 16th the Allied plenipotentiaries met at London, and it was in the same spirit that on August 5th, the German delegates, Chancellor Marx, Foreign Minister Stresemann, Finance Minister Luther, and Herr von Schubert, joined the conference. The American government was represented by unofficial observers in the persons of Ambassadors Kellogg (Ambassador at London) and Houghton (from Berlin). Owen

D. Young attended at the invitation of the governments concerned.

Animated though it was by a determination to agree, the conference was occupied with its labours a full month, and it was not for still another two weeks that, on August 30th, the final ratifications of the treaty were exchanged.

By this treaty, known as the London Agreement, various administrative details were agreed upon; provisions relating to arbitration of all differences which might arise were adopted and a schedule was established governing the successive steps to be taken in the withdrawal of Franco-Belgian fiscal and economic interference in the Ruhr, these steps to be dependent upon the voting by the Reichstag of the laws necessary for the working of the plan and the fulfillment of other features. Until the loan project should be concluded, it was provided that the German government should finance instalment payments to the Agent General on the reparation annuity. While the various steps necessary to the complete installation of the machinery of the plan were being taken, the plan was to operate in what was defined as the "transition period."

In addition, the Allies among themselves agreed to amend the Treaty of Versailles by adding to the membership of the Reparation Commission, for all questions under the Dawes Plan, an American citizen (sitting as an individual and not as a representative of his government). They also wrote into

the Treaty of Versailles the right of any member of the Reparation Commission to appeal to arbitration in case of a decision by the Commission granting or rejecting an application that Germany be declared in default.

By a side agreement between the French, Belgian, and German governments, it was arranged that, if the provisions of the new treaty were carried out "in the spirit of loyalty and pacification which had inspired the deliberations of the conference," the military evacuation of the Ruhr would be completed within a year's time.

On September 1, 1924, the day after the signing of the London Agreement, the Dawes Plan commenced to operate in the transition period, under the sagacious administration of Owen D. Young as Agent General *ad interim*. The German government made its first instalment payment on account of the annuities, the Agent General commenced purchasing for cash the coal, dyestuffs, and other materials offered by German contractors in fulfillment of reparation delivery programmes, and the French and Belgians began to turn over the control of the fiscal and economic affairs of the Ruhr to the Germans. It was an anxious period, but everything moved according to schedule or ahead of it. By October 28th, the economic evacuation of the Ruhr had been completed, the loan contracts had been signed, and all the necessary legislation had been passed. On that date, therefore, the transition

period ended and the plan came into full effect as a part of the public law of Europe.

In the space of a few months' time, a completely new spirit had been carried into the reparation problem; a completely new system had been evolved for dealing with it; and the outlook for Europe had been completely changed from the prospect of disintegration which it faced the year before. An achievement of such breadth, touching so many aspects of the material and moral organization of society, and constructed with such patience and sagacity out of the clash of great forces is capable of many different characterizations.

In the popular view, the making of the plan is an achievement of the first rank in the field of applied economics. Perhaps we need not go much beyond that definition in order to see the plan in its fullest significance. For the field of applied economics is a broad one, embracing vastly more than scientific formulæ, and in its international aspects, at least, vastly more concerned with problems of social and political philosophy than with economic mechanics.

The authors of the plan brought into the solution of a problem, widely regarded as a purely technical one, all those imponderable factors which had been thrown out of court by the edicts of modern economic science. Into a great problem of international finance they introduced the almost forgotten features which are of the essence of finance—those

fundamentals of credit which never appear on a balance sheet.

Credit is a far greater word in the vocabulary of society as to-day organized than ever before. Its primary connotation is a moral one; and it carries that meaning with it into the field of finance. The Dawes Committee built that moral factor into the reparation problem, not with an ax, not by rude exhortation or an arrogant display of contempt for lesser minds, but by joining one piece patiently with another, by the exercise of reason, of understanding, and of toleration. The making of the Dawes Plan was one of the greatest credit operations, in the widest sense of the term, ever executed within a brief space of time. It was a shining example of the capacity of the human intellect and conscience to construct and not destroy.

Some say that public opinion made the plan. It is a modern fad of writers of history to deny the existence of makers of history. To that school the influence of great individual minds and characters on the course of events is merely the reflex of the public mind, working blindly toward a preordained end. Courage, patience, toleration, knowledge, all the great attributes of men as individuals, are regarded as quite impersonal—for if they had not cropped out in one set of instruments of public opinion, they would have been found elsewhere.

It satisfies the plain man, however, to interpret

history in a less esoteric fashion. Extended experience with the smallness of small-minded public servants has taught him to appreciate greatness when he sees it. He recognizes the limitations upon the constructive power of that public opinion of which he is a part, and he appreciates the part played by the instruments who supply those deficiencies.

Public opinion is capable of seeing a broad end which ought to be accomplished, of pointing out that end, and, when aroused, of insisting that it be reached. But it is rarely able to concern itself with the means to the end. In the last analysis, public opinion knows but one means, and that is direct action—our modern euphemism for revolution. To find a rational means to the end, the public has to rely on the intelligence of its servants. If they fail, everything fails but the rule of chaos.

The man in the street knew that something needed to be done about reparations, and, once aroused, the pressure of the opinion of millions like him was unquestionably a powerful factor in the settlement. But the admonition to do something was a vague one. What, precisely, was to be done and how was it to be done? Something concrete had to be provided for public opinion to take hold of—something which had to be sound in its fundamentals and could not avoid being intricate in its details if it was to meet the exigencies of the case.

The plan which emerged, built to stand the test of a hydra-headed world opinion, was the work of individuals, and to individuals belongs the honour. Many able minds and devoted spirits contributed to its making and its acceptance. But chiefly it was the accomplishment of three men. In the three years which have elapsed since their work was completed, Dawes, Stamp, and Young have shown a singular generosity in their estimates of the work of others and of each other. History, however, will demand that the distinct contributions of these three very differently gifted men be weighed.

The great contribution of the chairman of the Committee was that of a leader before the public, endowed with qualities which commanded their confidence and stirred their interest. General Dawes, as we have already said, rallied the French to the Committee. He was also in a large measure responsible for bringing about a greatly increased coherence in American opinion and for the pressure on Europe which resulted from it. The Committee felt that pressure. All Europe felt it; and it worked in the interest of peace. Europe began to realize that America was back on the job, prepared to put its great weight behind the settlement if an agreement could be reached. General Dawes interpreted the reparation question to a befogged American public, he brought its salient points out in sharp relief and paved the way for acceptance of the plan by the American people. The prestige which

this brought him in Europe he exerted throughout on the side of moderation and in the interest of dealing with conditions rather than theories.

When the work was ended, he made a final indispensable contribution in his letter of transmittal, which in a few paragraphs outlined the principles of a complex settlement in such a way as to carry conviction to the plain man. To large sections of the American investing public, whose support was essential to its success, the guarantee of the plan lay in the signature of General Dawes, backed by his known integrity and business acumen.

Sir Josiah Stamp ranked as the Committee's foremost technician. Already distinguished in England as an economist and statistician, he emerged from the crucible of the Committee's labours with a European reputation. From long familiarity with the subject, he was especially qualified to deal with matters relating to taxation. But he had a varied range of powers and left his impress on every part of the plan. The views expressed in the report on the assumed difficulties of transfer and the supposed distinction between the burdens of an internal and an external debt, which apparently must be attributed to him, this writer considers his least valuable contribution. But his other contributions were of an impressive character. He possessed the scientific instinct at its best, he had a capacious and well-stocked mind, and he was tolerant in his judgments. These qualities, together with a great and

obvious sincerity, made his part in the making of the plan one of very large importance.

Owen Young brought to the Committee a broad experience in the conduct of affairs, notably as head of one of the world's largest industrial undertakings. He brought, as well, a mind of great range and penetration, an immense humanity, and a capacity to inspire trust and affection in his fellows. There seemed to be much of the dreamer in him. He was an idealist, but no realist ever had a more shrewdly practical outlook when confronted with a specific problem to unravel. He made no claims to profound familiarity with economic theory. He made, in fact, no claims to anything. But as the forces which were convulsing a continent came to a focus in the Committee room, it was more and more to him that men turned for wise and workable solutions.

As the plan took shape, it became apparent to close observers that an intelligence of the first order was bringing the Committee honourably through the collisions of powerful interests and convictions which threatened to destroy it, and was welding the technical proficiency and high purpose of its members into a serviceable instrument. It was Owen Young who supplied that quality of high statesmanship. He saw the reparation question as a whole, and related all its multifarious elements to the central conception of a problem in international understanding. He possessed an extraor-

dinary power to bring men's minds to common ground—a power which lay in the fertility and discernment of his own mind and the deep persuasiveness of a lofty character. The part played by Owen Young throughout a critical ten months in the history of Europe marks him as one of the truly great figures of the generation.

CHAPTER XI

THE LIQUIDATION OF THE REPARATION PROBLEM

THE Dawes Plan remains the central feature of the present structure of international trade and finance. The full and free action of the forces now making for the economic restoration of Europe and thus in great measure for social health and political stability depends upon its continued operation.

To date, the plan has functioned without serious hitch, in the manner contemplated by its authors. It is being intelligently administered by a competent interallied organization. This organization comprises the Transfer Committee and the various commissioners and trustees contemplated by the plan. It is headed by an able and broad-minded American lawyer, S. Parker Gilbert, formerly Under Secretary of the United States Treasury, whom the Reparation Commission selected as Agent General to succeed Mr. Young at the close of the transition period in 1924.[1] All the testi-

[1]Besides those already mentioned, several Americans, acting as individuals and not as representatives of our government, occupy posts of importance in the reparation scheme. Thomas Nelson Perkins, the Boston lawyer, is chief arbitrator under the Dawes Plan. Walter P. Cooke, of Buffalo, sits on the Reparation Commission at Paris as a full member in the capacity of an American citizen, along with four members who officially represent respec-

mony is to the effect that the governments who are parties to the London Agreement have coöperated wholeheartedly in carrying out the plan.

Unquestionably, the plan has great momentum. It is powerfully supported by world opinion. Its future, while in no sense guaranteed, seems by no means insecure. It would be idle, however, to deny the existence of strong counter movements directed to the premature shortening of its life. The points of attack are the American investor, who furnishes the foreign exchange required for the transfer of payments, and the German taxpayer, who pays the bills.

In effect, if not by intention, the economic theory of the export surplus is directed toward breaking down the confidence of the American investor in the practicability of the plan. The most serious recent development in the propagation of the psychology of a breakdown is the attitude of the president of the Reichsbank. It has been apparent for some time from his utterances and from the policy of the Reichsbank that Dr. Schacht wishes to restrict the placing of foreign loans in Germany. The nature of his convictions on the subject and

---

tively the British, French, Italian, and Belgian governments. The duties of unofficial observer for the American government, which were performed successively by Hon. Albert Rathbone, Hon. Roland W. Boyden, and Colonel James A. Logan, are now discharged by E. C. Wilson. Leon Fraser, of New York, is legal adviser and Paris representative of the Agent General for Reparation Payments. Shepard Morgan, of New York, is American member of the economic service at the Agent General's Berlin headquarters; and Richard B. Wigglesworth, of Boston, is assistant to the Agent General.

the manner in which he relates them to questions affecting the operation of the Dawes Plan have become evident only with the publication in Berlin of his recent book (1927) on the stabilization of the mark, in which he devotes a chapter to foreign loans and transfers.

Dr. Schacht apparently has come to the conclusion that there is something unnatural in Germany's employing foreign capital for her restoration, and he is convinced that the transfer of reparation payments against the foreign exchange provided by foreign loans is wrong and dangerous.

The Reichsbank president is a thorough convert to the doctrine of transfer difficulties. He goes a long way beyond others of the school. He says that transfers ought not to be made and cannot possibly be made against foreign loans. He says that the Committee contemplated that Germany should send abroad only what it realized from its foreign balance of payments, that is, reparations should be transferred only when and in proportion as Germany develops an export surplus. The plan, in his opinion, never contemplated that transfers should be made against loans. The adoption of such a scheme, he intimates, would have prevented the return of that confidence upon which the Committee laid such stress. "What foreign creditor," he asks, "would lend another penny to Germany if he knew that his money would be used for the direct payment of

reparations instead of serving to strengthen the economic productivity of Germany?" The utilization for reparation transfers of foreign exchange thus procured only stores up trouble, Dr. Schacht believes, for the future. In his opinion, the loans represented by the foreign exchange thus used will not play their part in producing the export surplus which will be needed when foreign exchange is ultimately required for their repayment.[1]

To reply in detail to the doctor would be merely to repeat much that has gone before.[2] His ideas are all variations of certain misconceptions, already discussed, regarding the nature of capital, the mechanics of its distribution, and the rôle of debtor and creditor countries in the world system, plus

---

[1]P. 180, et seq., op. cit. (p. 120, above). The book is in German.

[2]We will, however, in reply to his question just quoted, ask Dr. Schacht whether he has not overlooked the fact that the capital (that is, the goods) represented by the amount of the reparation payments has already been saved and set aside by the German taxpayer, and therefore that that portion of the loans made by foreign lenders which is not shipped into Germany in the form of real capital or goods (being set aside in the form of foreign exchange for the transfer of reparation payments) operates to release to the German economy a corresponding amount of real capital in Germany which is under the control of the Agent General. This same principle applies to transfers made for the payment of interest owing by Germans on any foreign debt, whether reparation debt or commercial debt. The saving of money for the payment of debt brings new capital into being (capital being real goods saved over consumption), and the mechanics of utilizing foreign exchange provided by new foreign loans against which to transfer interest on the old debt keeps that new real capital in Germany. Operations of this sort have been going on for decades. Germany is not a new kind of debtor country, nor from the standpoint of "transfer" is the reparation debt a new kind of debt. The lender of new money to a debtor country need have no fear that the mechanics of exchange will affect in the least degree the character of his loan as a productive loan. Any foreign loan made for productive purposes is bound to be productive. The mechanics of exchange have nothing to do with the matter. It is these mechanics which confuse Dr. Schacht. He thinks of capital as bills of exchange or bank credit, whereas capital is goods.

certain assumptions regarding the intentions of the authors of the plan, evidently based on the passage relating to loan operations to which we referred at page 175 above, in discussing the transfer problem. It is more appropriate here to consider the significance of the fact that views of this kind are held by the president of the Reichsbank.

If Dr. Schacht adheres to his opinions it seems likely that they may have a temporarily unsettling effect. Translated into Reichsbank policy, they have already this year resulted in an effort, since abandoned, to force the interest rates of the country down to a point where foreign capital would not be attracted. They appear to have had their part in the break in the Berlin stock market of May, 1927. This crisis was precipitated by the announcement of a prospective curtailment of stock exchange loans, one purpose of which seems to have been to avoid raising interest rates during a condition of capital shortage.

Dr. Schacht says that the granting of loans by foreigners takes the control of German credit out of Germany and particularly out of the hands of the Reichsbank. That is so. That is not to say, however, that credits will be unwisely granted. But, even if they should be, the fact remains that it is the law of supply and demand against which Dr. Schacht is protesting. The conditions determining the granting of credit and the distribution

of surplus capital are international in their scope. There is no convincing indication that Germany is approaching the point of capital saturation. Indeed, there is no indication that in the modern world there is any such point; the demand created by new markets and by new inventions constantly bringing new kinds of product into public favour is insatiable. Capital distribution is governed by relative conditions. So long as the United States produces relatively more capital than Germany, the law of supply and demand, working through differences in interest rates, is likely in the long run to have its way and continue to feed Germany with foreign capital.

Conceivably, Dr. Schacht's views on loans and transfers and the views of those who think with him will bring a psychology of panic into the American mind in 1928. More likely, they will break harmlessly on the rock of reality and leave the American investor undisturbed in his present vocation of salvaging Europe through loans.

The considerations which will determine the attitude of the German taxpayer are of a different character. On him converge the arguments which go to the political roots of the problem. His continued support of the plan depends on his conception of the justice and expediency of the payments which he is expected to make in relief of the French taxpayer.

Perhaps the chief obstacle to a clear view in Germany of the reparation problem as an issue in international justice is the fact that, in the Treaty of Versailles, the payment of reparations was linked with the question of war guilt. The German government was required to subscribe to the acceptance of "the responsibility of Germany and her allies for causing all the loss and damage to which the Allied and Associated governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her allies." This declaration formed the first article of the section of the Treaty which dealt with reparations. Thus the Treaty gave colour to the still-prevalent idea that reparations are exacted as a punishment for crime, and that the moral justification of their payment lies in the guilt of the German people.

To those who disbelieve in that guilt, the payment of reparations has the repulsive aspect of a tribute exacted from the vanquished. Millions of Germans remain unconvinced that the origins of the war are traceable to sources within the frontiers of Germany. Other millions, while not prepared to deny that individuals or groups in Germany may have played a great part in precipitating hostilities, reject the idea of a national culpability carrying with it the liability of an entire people to a continuing punishment.

A considerable sentiment exists in Germany for

a revision of the Treaty clauses in which Germany's responsibility for the war is affirmed, and with the hope for revision appears to go a corresponding expectation that the reparation debt will be wiped out. It is that expectation, in fact, which gives the movement much of its vigour. Now, whatever happens to the Treaty clauses in question, it is obvious that the reparation debt must stand. In which direction lies the escape from this potential dilemma and its threatening possibilities?

It is impossible that escape should lie through conversion of the German people to the acceptance of war guilt. World opinion no longer supports that thesis; since 1919, it has moved steadily toward a reaffirmation of the philosophy of Edmund Burke, who found the notion of a willful criminality of a whole people too big for his ideas of jurisprudence. The only way out of the dilemma will be through a more general understanding in Germany that the reparation obligation fundamentally rests on the principle of an equitable distribution of war burdens. To the growth of such an understanding, the Dawes Committee gave a great impetus by its definition of reparations as Germany's equitable contribution to the reconstruction of Europe.

There is no denying the existence of a feeling of restiveness in Germany under the burdens of the plan, or the fact that that feeling is becoming more outspoken. In the Reichstag debate on the 1926–1927 budget, the correspondent of the New York

Times reports:[1] "Spokesmen officially formulating the views of all the parties, even the Communists, agreed that the present schedule of reparation payments could not be carried out indefinitely. Party speakers almost without exception stressed the nation's conviction that payment must be made to the Allied powers, not because of any moral motive, but simply because Germany lost the war. In other words, the German parliament was a unit in rejecting the Allied thesis of the German Empire's sole guilt in precipitating the outbreak of hostilities."

Whether a better understanding of the nature of the reparation obligation would of itself create in Germany a vigorous national conscience on the subject of reparations may be doubted. It would be a good deal to expect from human nature. Sharing the burdens of other nations is not a subject which in any country arouses spontaneous public enthusiasm. But the absence of any conviction as to being the victims of an unjust settlement ought to be sufficient to protect the plan from repudiation by the German people. For if the public mind were reasonably clear on the issue of justice, considerations of expediency might be expected to exert their full influence in protection of the plan.

Men's memories are proverbially short; but there is evidence that the advantages accruing to Ger-

[1] April 1, 1927.

many by reason of the reparation settlement are still recognized in high places. The government has promptly met all its obligations under the plan and has coöperated actively in the solution of problems involved in its operation. This shows not only good faith, but good sense. So far, German policy has been guided by men who are able to recall with profit the horrors from which the Dawes Plan rescued their country and to appreciate the continuing benefits of peace which it confers.

That the present provisions of the plan must be accepted as the immutable measure of the equities in the case, its authors would unquestionably be the last to maintain. It was part of their wisdom that they did not claim finality for the plan. New facts may change the picture. Particularly, the operation of the prosperity index, if it should result in a large supplementary payment, may call for a partial reopening of the case. It is true that a contract is a contract. But it is also true that the essence of this contract was equity, so far as it is within the reasonable power of the human mind to define it. The appellant, however, must be required to show a very strong prima-facie case, for it is evident that even a partial reopening of the settlement would be a delicate operation, attended with grave risks for all concerned.

In due time, Germany will move to have a limit formally set to the duration of the reparation annuities. She will be entitled to have the total

obligation fixed, whether stated as a terminable annuity or, in equivalent terms, as a capital sum on which her annual payments under the plan will be allocated as between interest and sinking fund.[1] There is no good reason for haste in this matter, for, as has already been suggested, it seems clear enough from the general conditions of the plan that the annuities are to be considered as running to 1949 and a portion of them to 1964. There is every reason, on the other hand, for the greatest circumspection in reapproaching this old and sore subject of a definite and formal revision of the Treaty debt.

One of the chief dangers in that connection comes from enthusiastic amateurs who have not seen the horror and bitterness of the reparation dispute at close range, and who have a passion for crossing the t's and dotting the i's of an infinitely complex settlement. The essence of their complaint, though they may not know it, is that nature should evince a disposition to take a generation's time to repair the wounds of the war. What annoys them, essentially, is that the repa-

[1]The payments being made on the railway and industrial bonds are already allocated between interest and sinking fund. Technically, the allocation to sinking fund is for the purpose of extinguishing the debts in 1964 as debts of the railways and industry respectively. No provision has been made requiring that these sinking-fund payments shall be considered as extinguishing in corresponding amount or in any other proportion the capital obligation of the German government on account of reparations. Technically, the 33 billion dollar capital obligation fixed by the Reparation Commission in 1921 still stands, subject to relatively small payments allocated to reduction of principal prior to the coming into force of the Dawes Plan and certain deductions on account of cessions of properties, the values of which were to be fixed by the Commission. The net figures, as stated in a previous chapter, may be taken as in the neighbourhood of 31 billion dollars.

ration problem should be the expression of a world catastrophe, that the depth of the problem should be proportionate with the immensity of the disaster and that the solution of the one should proceed no more rapidly than the repair of the other. With the utmost good will, therefore, they are bent on tidying up the arithmetic of reparations in a completely logical fashion.

Until a substantial capital payment can be made in cash, it is difficult to see what practical purpose would be served by a movement for the settlement of this question, or to believe that such a movement would be other than futile and dangerous. That a cash payment large enough to bring about a final settlement can be made for a good many years seems unlikely.

The most suitable means to this end would be the public sale in the United States and elsewhere of the railway and industrial bonds now in the possession of allied trustees. In their present form, being payable in marks, they are scarcely salable abroad; but this objection could presumably be overcome. They have a total nominal value equivalent to 4 billion dollars, but as they carry only 5 per cent. interest, their theoretical value to-day in a market in which excellent European bonds sell to yield 6 per cent. would be considerably less than their face. It seems altogether probable that the marketing of any considerable part of these bonds for the benefit of the Allied treasuries would

be made the occasion of bringing about a general settlement involving liberal concessions to Germany by the Allies.

There are, however, serious obstacles in the way of such a settlement in the near future. We have estimated that under the Dawes Plan the Allies are entitled to receive in a standard year an annuity equivalent to interest at 4 per cent. and sinking fund payments on a capital sum of 9 billion dollars, plus or minus adjustments due to the operation of the prosperity index. Short of a complete wiping out of interally debts, it is inconceivable that any bond flotation small enough to be manageable at this time would be large enough to induce the Allies to make a clean sweep of the rest of the reparation debt.

It is also to be borne in mind that the trend of European economic thought has not been such as to strengthen the value of European securities on the American market. Until the transfer agitation in all its phases has run its course, it is questionable whether, even in a market of the immense absorbing power of ours, the reparation bonds could at any price be sold in sufficient amount to advance the problem very much toward a final settlement. When the time comes for floating them, the question may then arise as to the extent of the resulting interference with the satisfaction of the new capital requirements of industry both here and abroad, and as to the relative importance of the competing

demands. That bridge, however, does not need to be crossed now.

In the passage of time, it is scarcely to be doubted that the disappearance of the reparation debt will become an end of statesmanship in France itself. The reparation debt is a political debt—a debt between taxpayers—and as such has nothing to recommend or support its continued existence when its primary purpose has been measurably accomplished. Its reason for existence is the equalization of national burdens during a period of extreme exhaustion. When the exhaustion becomes perceptibly and permanently less intense, the sanctions behind the debt will correspondingly relax. An inter-taxpayer debt, without the sanction of some high social purpose or deep principle of international justice, can serve no ends but those of domestic buncombe and international mischief-making. Of that truth we may feel reasonably sure that the real statesmanship of France, the great creditor on reparation account, as well as of America, the ultimate creditor on all the debts, will before many years be fully persuaded.

But until the United States makes much greater concessions on the interally debts than so far made, the cancellation of the reparation debt cannot be a proper immediate object of statesmanship or a practical proposition in the domestic politics of Germany's largest creditor without a considerable down payment in one form or another.

It is apparent that the present trend of Franco-German relations will facilitate a settlement, when the time comes for it. France still has to stabilize her currency and weather her deflation crisis. The natural tendency of that period would be to put a strain on the new rapprochement, though so far such a result has not appeared. Meantime, as an influence of the opposite tendency, the recent pooling of the French and German steel industries is a factor of importance. It is not impossible that, in the development of those industrial relations, so significant to the cause of a lasting peace between France and Germany, will ultimately in some fashion be found the compensation for France.

CHAPTER XII

THE TRANSFER 'BUGABOO' AND THE AMERICAN INVESTOR

IN A previous chapter we dealt with those aspects of the transfer problem which primarily concern the Dawes Plan. We saw that the mechanics of transfer is being cared for to-day through foreign exchange provided by foreign loans to Germany, chiefly by American investors. We have dwelt on the fact that American loans to Europe not only contribute to a solution of the reparation problem in this technical sense, but also that, by replacing destroyed capital and stimulating productivity, they help to relieve the exhaustion which is the fundamental cause of the problem.

In our previous discussion, we remarked that the new conditions in which America has taken the place of England as chief lender to the world are characterized by British economists as essentially temporary, abnormal, and dangerous. We recounted that one of the alleged threats in the situation is that a solution of the reparation problem is not really being accomplished by loans, but only dangerously deferred; and came to the

conclusion that this danger exists chiefly or entirely in the minds of the economists. It remains to discuss a related aspect. That aspect is the alleged danger to America and the American investor.

Though the prospective calamity to this country is but vaguely defined, our attention is constantly directed to it in terms and tones which lack nothing in positiveness. We are told that the "piling up of loans" is dangerous. There is something about it, quite distinct from the matter of business risks, which fills the economists with deep forebodings. Apparently, they have no doubt as to the danger being something very real. But they do not tell us precisely what it is.

Mr. Keynes gives us a sample of these dark prognostications: "Reparations and interallied debts," he says, "are being mainly settled in paper and not in goods. . . . How long can the game go on? The answer lies with the American investor. . . . The moment when cancellation becomes a living topic, an unavoidable burning issue of practical politics, will be when the circular flow of paper is impeded and the artificial equilibrium broken. It will be for the American investor in due course of time to give the word—and for the American public to find the solution."[1]

There seem to be two separate suggestions in Mr. Keynes's words. One of them is the idea that, when the loans stop, it will be impossible to trans-

[1]J. M. Keynes, *The Nation and Athenæum*, London, September 11, 1926.

fer the payments on the war debts. This is an old friend which need not detain us here. It is the other idea that interests us at this point—the suggestion of a "game" now in progress. What is the meaning of Mr. Keynes's references to a "circular flow of paper" and an "artificial equilibrium," one of which is due to be impeded and the other to be broken?

What does this unhealthy picture of the present situation imply, and what do these dark suggestions as to coming events portend? Apparently there is something very wrong with things as they are. Apparently the whole scheme of loaning money to Europe is a huge artificiality. Apparently it deserves to come down with a crash and, if we understand Mr. Keynes correctly, it is going to do so very soon. We take it that something most unpleasant hangs over the head of the American investor.

What is this calamity which is impending? What, if anything, does Mr. Keynes mean?

Before attempting to answer that question, let us first see how close the American investor has now come to occupying that position—that unpleasant position, if Mr. Keynes insists—which the European investor occupied in 1913. It was then that the European investor was regularly cashing coupons and dividend checks on 33 billion dollars of his money loaned out to debtor countries. In actual comparable figures, how desperate has the posi-

tion of the American investor so far really become?

According to estimates by the Department of Commerce, our foreign investments at the end of 1926 amounted to 11,215 million dollars, of which 3,010 million were in Europe, 4,500 million in Latin America, 2,801 million in Canada and Newfoundland, and 904 million in Asia, Australia, Africa, and elsewhere.

If we add to this the nominal value of the interally debts owing to us, amounting to about 10 billion dollars (the real present value being about 7 billions because of the fact that the interest payments have been reduced to rates lower than market rates), the gross capital indebtedness of the rest of the world to the United States is about 21 billion dollars. Against this is to be offset about 3 billions of foreign holdings[1] in the United States, leaving a net nominal capital obligation to us of 18 billion dollars, or, taking the interally debts at their real value, 15 billion dollars.

Before the war, the world capital obligation to Europe was about 33 billion dollars.[2] Owing to the depreciation of gold and corresponding increase in prices of 50 per cent. since 1913, the pre-war indebtedness to Europe, on a basis comparable to the 15 billions now owed to us, would amount to about 50 billion dollars (30 billion to England, 12

[1]Not including 1.2 billions (net) deposits and loans due to foreigners by American banks.

[2]Estimates by Harvey E. Fisk, op. cit. (p. 10, above).

billion to France, and 8 billion to Germany). We therefore still have some 35 billions to go before we shall be in that position toward the world which Europe occupied before the transfer problem was discovered.

During 1926, we moved nearer to Europe's prewar position by about 700 million dollars, net, as follows:

Year 1926	*Millions of dollars*	
Investments made by us abroad (excluding refunding loans);	1,465[1]	
Deduct: Investments resold to foreigners, bonds redeemed and interally debt (35 m.) paid off	676	789
Less: Investments made by foreigners here (excluding 359 m. in bank deposits and short-term loans)	159	
Deduct: American bonds redeemed and U. S. currency (40 m.) returned from abroad	65	94
Increase in our net foreign holdings during 1926		695

Exclusive of refunding loans, our purchases of new securities abroad during the first half of 1927 were 726 million dollars. It is to be noted, however, that the gross investment abroad is always subject to a considerable offset for investments resold,

[1]Net amount made available to borrowers, after commissions and discount, 1,345 m.

investments made by foreigners here, etc. As the above figures show, this offset during 1926 was about 50 per cent. During 1925, the offset was of similar magnitude, and during 1924 about 37 per cent., bringing the figures for those years down to 494 million and 572 million respectively.[1] It is the net figure which denotes the effective amount invested abroad each year. The figures ordinarily published in the newspapers represent gross purchases of foreign securities in this country. Even these figures are by no means startling. When they are reduced by the amount of refunding issues included in them and by the other appropriate deductions, the net change in our position is relatively insignificant when compared to the distance which we still have to go.

Now, to return to the suggestion of danger in the "piling up of loans." Size, as a threat in itself, is one of the dangers implied. When we examine comparative figures, it does not seem impressive. Size, as affected by the transfer problem, is another. How are we to get our money back? It is the familiar question as to how the payments on the reparation debt are to be transferred. Let the economists phrase it:

---

[1]For a more complete discussion of the 1924 figures, including an analysis of the exchange operations of that year, see "The Transfer Problem—Bugaboo of Our Foreign Trade and Investment Operations," George P. Auld, the *New York Times Annalist*, June 8, 1925. The tabulation on page 275 is derived from figures appearing in "The Balance of International Payments of the United States, in 1926," by Ray Hall, Assistant Chief, Finance and Investment Division, Department of Commerce.

QUESTION BY THE ECONOMISTS (*following the Socratic method*): As your debtors have no export surplus, how are you to get your interest on this huge debt of 15 billion dollars which is increasing at the alarming rate of six or seven hundred million dollars a year?

ANSWER (*in the American mode, by asking another*): How did Europe collect its interest on the 50 billions owed to it by debtor countries?

QUESTION BY THE ECONOMISTS: By making more loans, if you insist. But we know more about such things now. Consider carefully, when the time does come when Europe has to pay you by a surplus of goods, how impossible that a surplus so large can be developed, or if that does not alarm you, how unpleasant it will be for you to receive it.

ANSWER: Fifty billions minus 15 billions is 35 billions. Divide this by 700 millions. The answer is 50. We are very much engaged at the present time, and suggest that the matter be discussed a little later, say 50 years from now.

The answers appearing in this imaginary colloquy will be regarded by some persons as frivolous. That is a curious circumstance, if one considers it. It is curious that, in dealing with the prosy subject of debt payment, the argument from experience should be regarded as levity. It is an interesting

commentary on the power of a superstition, or, if one prefers, it is a striking example of the triumph of the subjective mind over the dull facts of existence.

In the circumstances, it seems essential that we try to penetrate the metaphysics of the economic mind. We shall have to try to find out what Mr. Keynes is driving at. It appears to be this. He believes that England and doubtless the rest of the world would be much better off if the international war debts were out of the way. It has become obvious to him that the reparation debt must stand, unless and until the United States relieves France directly and through the indirect chain of debt owing by France to England and by England to the United States. He has a theory that these debts cannot be paid on account of the difficulties of transfer. He believes that cancellation will be facilitated by hammering this theory home.

He finds, however, that this is not the case. As a future hypothesis, the theory does not get home to the plain mind, and as a present condition it is rendered false as a result of American loans. Mr. Keynes then produces another future hypothesis—that the loans will not go on for long. His reason for this is cardinal to the whole subject with which this book deals. He believes that Europe paid for the war out of income, that it has not suffered extensive capital losses, and that it will not, there-

fore, need the assistance of American capital for any extended period. In a word, he believes that Europe has recovered. If he does not believe that, his predictions that the loans will cease, that the "flow of paper" will stop, are without any meaning at all.

Believing that Europe is recovered and that the loans will therefore cease, Mr. Keynes and his school have the satisfaction of predicting that the war debts cannot be transferred much longer. But this second theory of theirs, like their first one, does not get home to the plain mind. They then proceed to paint a picture of danger to the American investor. Presumably the danger is that he will not get his money back because of transfer difficulties. But the investor is fairly serene about the matter of foreign investment, and he will reply with the argument from the experience of England.

What, then, is left to these earnest gentlemen who believe that all the world is out of gear? For his own good, the investor must be convinced, if not in one way then in another. And so the impressionistic method is adopted. The detail is painted out of the picture, and the danger is painted in as something vague, dark, and mysterious.

We assume that Mr. Keynes wants to be taken seriously. And as he is dealing with phenomena of credit, it is not impossible that he will be. Suppose,

then, that the American investor, from causes unconnected with the operation of his reasoning faculties, should conclude that this "circular flow of paper" is in truth due to be impeded, that the "artificial equilibrium" is due to be broken, and that the unpleasant results which those events would portend are due to arrive. Then it will indeed become certain that the equilibrium will be broken, for the American investor will break it himself by throwing his European securities on the market and declining to subscribe for new issues.

But, suppose that Mr. Keynes should then make the discovery that he is mistaken in his theory that Europe does not need American loans any longer. What alternative scheme for the reconstruction of Europe will he then be prepared to offer?

If the object of all these incantations of the economists on transfers and loans is cancellation of interally debts, the game is not worth the candle. The danger in the situation, if there is one, is not primarily to America, but to Europe. The danger is that we may take the European economists seriously, as thousands of intelligent people did during the critical days which preceded the Dawes Plan.

Have the economists really thought the matter through? Are they really prepared to meet the situation which the propagation of their theories logically promotes: the shaking of the confidence

of the American investor and the potential closing of the American investment market to European securities? How do they propose to time the arrival of this situation so that it will coincide with that speculative date when Europe's capital needs will be satisfied? A little miscalculation by the experts on this point, a little gap of a few months between the arrival of the two events, and the damage would be done. They seem to be staking a good deal on their abilities in the field of scientific forecasting.

More than that, they are staking it on a theory regarding the probable position of Europe in the world system of this generation, which many facts —perhaps most facts—go to show is totally wrong. The possible error in their calculations seems likely to be one of decades rather than months.

The concern of the economists over the flow of American capital to Europe seems to be the expression of a state of incredulity that the war which they believed to be economically impossible did actually happen. If Europe has already recovered from that impossibly big war, it must be that it was considerably less of a war in its economic effects than the economists anticipated. If this is so, if Europe is really due to go back promptly to a creditor position, then the export surplus difficulty urged as a reason why our loans cannot be paid has been solved, and Mr. Keynes's cancellation theories are once more subject to some slight revision.

Has the transfer problem any sensible meaning whatever? If one has the patience to follow its various hypotheses through to the end, they dissolve in inconsistencies and absurdities. They seem to be merely a disconnected series of ill-defined figments of the imagination. We have attempted to pin these furtive images down by the ordinary reasoning methods known to the plain mind. They lead us inevitably into a form of rebuttal which itself has an air of unreality. If such an impression is gained from these pages, if some of them are reminiscent of Alice's Adventures in Wonderland, we submit as the reason for it that we have tried to take Mr. Keynes seriously and deal with his theories wherever they led us. We were induced to do this by the knowledge of his position of prestige in English economic thought. If, however, it is unnecessary to take his theories so seriously as to examine them in detail, we suggest, what we have suggested before, that the whole transfer doctrine, in all its ramifications, may be briefly and sufficiently answered by the argument from experience—the experience of England as a great creditor and of America as a great debtor before the war.

Besides the transfer problem, another spectre has to be exorcised before one can consider the question of our foreign loans on a realistic basis. This one, for lack of a better name, may be called the drain bugaboo. The idea is that the export of

our surplus capital will be a drain on our economic strength.

Look at England, the pessimists say. Did not the long-continued drain of investment capital out of England before the war weaken her? Was it not responsible in large measure for her present enfeebled economic condition? Would not England have been better off if she had kept this capital at home?

Assuming for the moment that the answers to these questions might be in the affirmative, the reply, couched in the same somewhat vague general terms as the queries, is that England before the war, with a third of our present population, and much less than our present economic strength, was annually lending abroad about as much as we are lending now.

But unqualified affirmative answers cannot be given offhand to the questions regarding England. It must first be asked, what use would have been made of her surplus capital if it had been retained at home? That capital was tangible goods—the surplus product of British industries, remaining over after the satisfaction of home consumption requirements and home demands for new capital. If its export were to be stopped, either the production of it had to be stopped, with unemployment as the result, or it had to be used at home. It had to be used in one of three ways: In building new plant, which implies still more pro-

duction; in government work, which implies higher taxes; or in consumption, which implies paying higher wages.

The first alternative of using the surplus capital in building additional plant at home is not a real alternative. Before this surplus of new capital remained over for export to British customers abroad British industry had already satisfied its needs for new capital to finance its necessary extensions. Those extensions were required in substantial part to provide output for foreign markets in new fields where the extension of consumption demands was continuous and almost unlimited. The product of these new plants was moving to countries where whole populations were beginning to use locomotives instead of horses and to wear suits of clothes over their shirts. But if England's export surplus were to be kept at home, what use would be made of these new plants and of the still more new plants to be built out of the embargoed surplus? Obviously, there would be no use for them at all, unless home demands for product were to be increased.

In order, then, to answer the question as to whether England would have been better off to have kept her export surplus at home, we must say whether that excess capital ought to have been used for public works and other expanded activities of government, involving higher contributions to the general welfare by the taxpaying classes,

or whether it should have been used for general consumption purposes, involving a general raising of the wage level by employers.

We shall not attempt to answer that question, for the reason that it proves to be irrelevant to the object of our discussion. Having discovered what the original questions regarding England really amount to, we may now return to our primary purpose. That purpose was to form an opinion as to the dangers confronting the United States in a policy of investing its surplus wealth abroad.

We said that, by some persons, England is pointed out as a horrible example of the results of such a practice. We now find that the suggestion of an embargo on foreign loans gets back to a question whether the functions of government require any considerable expansion or whether the wage scale and living conditions of the workers need substantial improvement.

Now, whatever may be regarded as the proper answer to that question as regards English conditions, it is apparent that it would have no bearing at all on the answer as regards American conditions. Our answer regarding our own problem, we think, must be that in this country we already have an overpowering sufficiency of governmental activity, and that the situation of the American wage-earner, broadly speaking, is an excellent one. There seems, therefore, to be no compelling reason in our general economic condition why we should

hesitate to place our surplus overseas, and fulfill our manifest destiny.

The economic dangers associated with foreign investment are nothing more or less than business risks. Foreign investment is a business. It goes hand in hand with foreign trade. The two, and particularly the first, demand special knowledge. They demand special judgment. And with respect to those essentials, we in America are still, relatively to the English, only amateurs. But we are learning fast. And we shall learn faster when we rid our minds entirely of the superstition that some profound economic mystery surrounds the business of foreign investment and that some occult danger hangs over its head.

This is not to suggest that the risks should be under-estimated. It is merely to suggest that they be viewed realistically. Obviously it would be folly to rush into indiscriminate investment of our funds abroad without careful regard to the circumstances in each particular case. During the past year there have been indications of such a tendency; and conservative bankers have properly emphasized the need for caution. It was a not unnatural result of what had gone before. The first great eastward rush of our dammed-up surplus after the Dawes Plan went into effect was slowing down. The profit in foreign financing had been large both to bankers and investors. The demand for foreign securities kept up. It tended to exceed the supply and to

stimulate a too-persistent search for objects of foreign financing.

Such tendencies will have to be guarded against in the foreign field as they have to be in the domestic field. Each risk will need to be properly weighed on its own merits, When that has been done and the sound risks have been assumed, the national danger to be apprehended from the "piling up of loans" will have been met and controlled. If the risks assumed by investor A are reasonably within A's capacity, and the risks assumed by investor B are within B's capacity, the combined risk of A and B is within their combined capacity. To imagine that in determining the national risk from the sum of the individual risks some geometrical ratio of increase comes into play or some extraneous element of economic danger is introduced, is mere superstition.

Superstitions of that sort, fears of mere size, fears of drains, of transfer difficulties, or of repayment in goods, lead to two absurd conclusions: That the American investor is forbidden by economic law to play the part in the world system once played by the European investor, and that the American producer is forbidden to assume the position in the world market once occupied by the European producer.

Unquestionably, the weighing of the business risks of foreign investment presents its difficult and complex problems. The granting of credit in

the foreign field requires a study of many factors, moral, political, general economic, and technical. Their difficulty and multiplicity need not, however, dismay us. What Europe has done in the past, we can do to-day.

The moral risks are no different from the moral risks which Europe once took in investing its money here. We are the children of Europe. Certainly, discrimination will be exercised in the matter of individual moral risks, and it may please some of us to fancy one people over another. But, broadly, if we disbelieve in the soundness of Europe, we shall merely deny our own heritage of blood and tradition.

The risks of political disturbances affecting our foreign investments constitute our most elusive problem. What those risks now are and what they will become from time to time must remain a matter of individual judgment, constantly requiring revision. We are entitled to believe, however, that, in the broad, political conditions will be a reflex of the general economic situation.

If the general economic situation is such as to ensure reasonable prosperity and contentment among the population at large, the danger of political disorders should not be great. Now that the violent stage of the reparation controversy has passed and Europe has got back to production, the movement is upward. Two major factors in the situation, one favourable and the other un-

favourable, are to be found in our loans to industry and in the taxpayers' debts. We, therefore, to a large extent, hold in our own hands the key to the problem of the general security underlying our loans abroad. Every loan, sound in itself, which our investors have made to European industry has strengthened the security back of all the loans. Every concession by our taxpayers to the European taxpayer will have the same result. We cannot lift from the European taxpayer's back the major burden—his internal public debt—but the portion which we do lift or decline to lift may be the decisive portion.

The technical aspects of our foreign risks present their own special problems. Many new conditions obtain in industry abroad to-day, and many of the old conditions still existent are new to Americans. But the proved ability of American bankers to deal intelligently with industrial financing at home is a guarantee that they will rapidly acquire competency in the foreign field. The question of technical security upon which they have to pass judgment is in one respect simpler than the problem which European bankers faced when they provided capital for American railroads and industrial undertakings. Those enterprises, many of them new, and placed in a background of general industrial underdevelopment, were, broadly speaking, speculative in character. On the other hand, European enterprise to-day, while not presenting the same possi-

bilities of growth, is a going concern with an established record and a great tradition of craftsmanship back of it.

With carefully chosen individual risks, the dangers to be encountered in our foreign financing will be comparable with those normal dangers which are everywhere associated with profitable business. Unquestionably, temporary depressions abroad will adversely affect our foreign interests. Unquestionably, losses from injudicious investment will be sustained. The controlling factor in keeping such losses at a minimum will be the judgment which, in any field of activity, whether foreign or domestic, marks the successful merchant and investor. In our new circumstances, that judgment will be of a new quality. It will require a broader base of knowledge, a deeper insight into affairs, and, in the last analysis, a greater courage. For all of these things, the rewards will be proportionate.

The prospect of these rewards, the spirit of high adventure, and, let us hope, the ideal of service, are pushing us forward into a world career. We are undertaking the rôle of world merchant and banker. It will have its ups and downs. We may be at this moment in a period of temporary recession from the first great spurt at the end of 1924. With the gradual recovery of Europe, it would be strange if such a mark were soon again reached. But it would be stranger still if our colossal industrial strength were not from now on much the greatest

factor in the world system in the steady production of new capital to be spilled over on to other less-favoured lands.

The responsibilities of this new career, its risks, if we choose to call them such, will not be solely economic. Inevitably, in the protection of our interests, we shall be involved in political questions. The scope of these questions will be subject to one important limitation. To-day no problem of surplus population presses us forward along the road of territorial expansion which Europe took. We have no desire to undertake the dubious and ungrateful business of empire building; and there is no immediate likelihood of our being pushed into it willy-nilly. But, apart from that, it will be strange if our foreign interests do not from now increasingly involve us in the annoyances, frictions, and critical complications of world politics. To meet them with the vigour which our interests demand and the tolerance which our ideals impose will require an attitude of mind such as we have not yet extensively cultivated in our dealings with other nations.

CHAPTER XIII

THE DEBTS AND OUR ECONOMIC INTEREST

OUR present attitude toward Europe lies under the charge of being crassly nationalistic. The term, as generally used, is misapplied. For in our policies there is little of the menacing aggressiveness toward foreigners which is characteristic of nationalistic schools abroad. In fact, except for an occasional outburst in the Senate, our attitude is distinctly impassive.

It is this very impassivity, however, coupled with an immense strength, which disturbs our neighbours. America is the great enigma, the great unknown quantity. And the unknown is usually sinister. Our impassivity on the question of interally debts has been especially disturbing to Europe. It has resulted in, or at least it has been followed by, manifestations of extreme irritation and resentment on the part of our former allies; and we are inclined to be resentful in turn. For we have thought that, in reducing the indebtedness from 10 billion dollars to something like 7 billions real value, we had done rather well by Europe.

The manifestations of European resentment are

plainly genuine, and they have a widespread popular backing. For that fact we have, broadly, a choice of two explanations. One of them is not convincing. It is not convincing that the plain Englishman or the plain Frenchman, or Italian or Belgian, is a quitter, a repudiationist, and an ingrate. It stands up better under the test of reason to believe that his attack of nerves comes from some heavy pressure of economic circumstance.

Is it possible that Europe is more seriously wounded than the economists have given us to understand? Is it possible that the plain man, feeling the hard facts of existence in every department of his daily life, knows what has happened to Europe better than the economic theorists? Is it conceivable that the theory that Europe paid for the war out of income is, in its broadest economic and social application, pure nonsense? Is it conceivable that the economists, intent on explaining to us the economic theory why debts cannot be transferred, have neglected to plough the field of economic fact?

If these things are possible, it is possible that the American people will have to display a greater intelligence on the subject of Europe's economic difficulties than the economic thinkers of Europe itself.

The surface symptoms to which the interally debt question gives rise are much less violent than those which marked the reparation controversy.

The most important reason for this lies in the overwhelming power of this country to impose its own terms. It may be objected that England is under no physical compulsion to pay her debt as she is paying it. That is the truth, but it is not all the truth. The British government would be unable to move toward repudiation of its obligation without doing its public incalculable harm.

None of the debtor countries is a free agent in the circumstances. Baldwin knew, when he signed the British funding agreement, that Europe could face only one thing worse than the problem of paying for the war, and that would be an attempt to solve the problem by repudiation. Every European statesman with the least grasp of the realities of the modern system of credit and finance knows the same thing. The Allied governments find themselves in a vise, lacking power to move on the debt question without further increasing their difficulties. What does this mean? It means that the United States is a party to a great issue and judge of it as well.

Any right solution must come on our own motion out of our own intelligence. Powerful considerations of international equity dictate that Germany must pay France. They run so deep into the fundamentals of social justice, they are such a vital part of the props of political order in Europe that they are identical for Germany with the highest considerations of self-interest. No such fundamental

considerations of social justice and the preservation of order dictate that the Allies should pay the United States. The situation is exactly the reverse. The deeper equities dictate that we remit our claims on the Allied taxpayers. And our interest in the stability of Europe points in the same direction.

What is this consideration of equity, which in discussions of the debt question has so often been confused with a weak sentimentality?

It will be urged that certain broad equities dictate that Europe should pay for Europe's war. That is true. It was Europe's war in the sense that America had no least part in bringing it on. Whether it was caused by an imperialist party in Germany or a general incapacity of European statecraft or an uncontrollable pressure of population, whatever the verdict of history on that question, it is undeniable that somewhere and somehow the war started in Europe.

But it is also abundantly clear that nothing can prevent the chief burdens of the war from falling on Europe. That will be so whether we cancel the debts or not. Those broad equities which demand satisfaction are a part of the inevitability of cause and effect. The special equities in the case begin to run at the point where the inevitable burdens of the population of Europe are supplemented by burdens which are not so inevitable. The idea that the European peoples are liable to a continuing

punishment which this country can easily lighten is a detestable one.

What do the interally debts mean in terms of a burden on Europe, or alternatively on us? Calculated at 5 per cent. (i. e., interest at 4 per cent. plus one per cent. for sinking fund) the charges on the whole of the original capital of the debts owing to us by Great Britain, France, Italy, and Belgium amount to about $4.10 a year per capita of our population. These same charges amount to about $3.67 per capita of the European populations concerned.

It does not seem a large sum. But everything touching the debt question is relative. Our people enjoy an average per-capita income of $670, which is two or three times that of Europe. We may better appreciate what $18 a year means to an average European family of five by considering what two or three times that, say $35 to $55, would mean to an average American family. We may then consider what this burden would further mean if placed on top of a burden of taxation for internal purposes now amounting to 20 to 25 per cent. of average gross income, leaving little or nothing for savings for the bulk of the population.[1]

Europe is our best customer. In 1925, it took more than 2½ billion dollars' worth of the products

[1]Taxes in the United States, in 1923, including federal, state, and local, were estimated by the National Industrial Conference Board to amount to 11.5 per cent. of income. *Tax Burdens and Public Expenditures*, 1925.

of our farms, forests, mines, and factories, or 53 per cent. of all our exports.[1] Can the average American taxpayer, head of a family of five, afford some substantial part or all of $20.50 a year in order to give our best customers some measure of relief, to obtain their good will, and to contribute to their political and social stability? That question appears to state the debt problem fairly and to answer itself in the affirmative. We have already cut the burden about a third. Have we done as much as reason dictates that we ought to do?

We have said that Europe is our best customer. We hear the reply that Europe is also our strongest competitor. That is true. But it may or may not be important. It probably is not. Business makes business. The healthy activity, even of a competitor, makes for greater activity on all sides and builds wider markets for everyone. An almost unlimited field of expansion in the undeveloped markets of the world beckons both to Europe and to America, and in these markets many of our

[1]Our total exports, in 1925, amounted to 4.9 billion dollars. Our six best customers took the following percentages of the total: United Kingdom, 21.1 per cent.; Canada, 13.2 per cent.; Germany, 9.6 per cent.; France, 5.7 per cent.; Japan, 4.6 per cent.; Italy, 4.2 per cent. From 1921 to 1925, Europe, as a whole, took 53 per cent. of our exports, including 74 per cent. of our crude material exports, 68 per cent. of foodstuffs, 49 per cent. of semi-manufactures, and 28 per cent. of finished goods.

See Department of Commerce Year Book, 1925, pp. 109, 112. Europe's total of 53 per cent. of our exports includes 7 per cent. to Holland, Scandinavia, and Spain.

Figures for 1926 show total exports of a million dollars less, with the same leading five customers in the same order, but Italy has now dropped below Australia and Cuba. Europe as a whole took 48 per cent. of our exports; North America about 25 per cent.; Asia and Oceanica, 16 per cent.; South America, 9 per cent.; and Africa 2 per cent.

products will be non-competitive. We are still supreme in the field of standardized product, and doubtless will be so for many years. The competitor rôle which Europe fills is not nearly so important to us as its customer rôle. The one clear fact to which we may unreservedly tie is the beneficent effect on our economic life which results from the buying power of a socially healthy and stable Europe.

In the matter of remission of interally debts, may the interests of our taxpayers as a whole fairly be regarded as identical with those of our farmers, manufacturers, merchants, bankers, and investors? In our circumstances, it seems clear that they may be. We confront no such iron dilemma as that of Europe in the matter of distributing heavy tax burdens. Our taxes, relatively speaking, are light. An inconsiderable contribution by the taxpayer in the interest of our foreign trade would be a good investment.

An investment such as this, with the broad national purpose of creating good will and promoting stability, is sometimes pictured as a contribution by the taxpayers which would go to swell in some illicit way the profits of our "international" bankers. It is often said that, if Europe can meet the interest payments on its market loans, it ought to be able to meet its intertaxpayer obligations. Remission of the latter is pictured as a bankers' "plot."

But the fact is that the market loans made by our investors are in no sense comparable to the interally debts. The latter were not incurred for productive purposes, and provision for their payment through taxation is correspondingly difficult. The money is gone long ago, and we all know what it went for. The market loans are of a different character. Those which are made to industry are self-liquidating out of the productive earnings which they help to create. Those made to governments are also in large measure productive. The German government loan and other such stabilization loans supplied a general foundation for healthful economic life in the community.

It has been suggested by a distinguished Senator of the United States that the market loans made to European governments should share in any scaling down of debts. It is hard to believe that such a proposal, involving ruinous losses to many of our small investors, could have been meant seriously. No such inequitable results would be involved in a remission of the debts owing to our taxpayers. The losses would be distributed through taxation, with a minimum of injury to individuals.

We are told by some observers that Europe is wallowing in wealth. But most of these accounts are by professional space writers who appear not to have carried their investigations much beyond the habitats of the tourists in the big cities and resorts. We are told that Europe wants to spend its

money on armaments. But we, in our relative impregnability of geographical position, spent in 1926 about 675 million dollars on national defence, while France spent about one quarter of that sum. We are reminded that the Allies have acquired large assets in the form of ex-German colonies. But we ourselves do not want to take those assets in settlement of the debts owing to us; and the Allies are unable to convert them from capital form into liquid form suitable for debt payment.

Lastly, we are asked if we wish to encourage the Allies to let Germany off on her reparation payments. Surely, our answer to that will be that the war is over.

Since the war, we have acquired an important national interest in the easing of international tensions and the resumption of normal conditions in the markets of the world. We now have an extraordinary opportunity to advance reconstruction, to our own benefit and the benefit of the world at large, by a sweeping reduction or complete remission of the debts. That we shall embrace it promptly seems unlikely, for we are only just beginning to acquire the world sense.

Meanwhile, the early payments required from the Allies, except in the case of Great Britain, are relatively small. European leaders who have world recovery at heart will recognize that fact and resist the temptation of picturing the United States as responsible for all of Europe's ills. The more

far-seeing of them will exhibit to their publics some faith in an eventual right settlement of the problem by the American people.

So long as such a settlement of the interally debt question remains in the future, reparations will continue to be the key problem of reconstruction, and the Dawes Plan will remain the chief guarantee of European stability. It holds the broken members of the European body in place while nature knits new tissues. The great part played by American citizens in its creation and administration has given the American people a sense of pride and proprietorship in the plan and an instinctive belief in its fairness and practicality. This attitude of our public has acted in restraint of hostile or doctrinaire attacks on the plan in Europe, and has been itself an important influence for stability.

Our instinct has been a sound one. But to meet the storm of controversy which seems to be brewing around the question of the transfer of reparation payments in the year 1928–1929, we need to supplement instinct with the force of reason. We shall need to protect our stake in Europe by the active exercise of our intelligence.

A gigantic industrial strength has given the United States a material supremacy in the world system which has not yet been leavened by the intelligence of its people. Until the nation finds itself in its new rôle, the world situation will be the

anomalous one of power resting in the United States, while the applied capacity to wield power remains elsewhere. We are still far from being equipped to deal with world affairs with the breadth of view and sureness of touch which characterized the pre-war leadership of England.

In England, wide sections of the home public were keenly aware of the influence which foreign affairs had on their own lives. From their applied intelligence, British official policy drew its strength, its alertness to their interests, and its responsiveness to their ideals. British policy was, and is, extraordinarily well knit. By comparison, we enter the arena of world affairs with no policy at all.

Those most directly concerned in the expansion of our economic life have gone the furthest toward a realization of the new order of things. Our manufacturers, merchants, and bankers, responding to a sound instinct for affairs, have projected their talents into the broader field. But in other departments the marks of a recent colonialism are still upon us. In economic thought, we have not yet declared our independence. In political thought, we still exhibit a lack of conscious relationship with the rest of the world.

As our economic life becomes more highly organized for dealing with foreign trade and finance on a large scale, the inertness of our national attitude toward foreign affairs will slowly be transformed into a vigorous and informed interest. It will be far

less intense than the psychology of 1917, but it will possess more of the characteristics of permanency. In a thousand ways, it is apparent that the gradual growth of such an attitude is under way.

In this movement, the influence of the new economics is being strongly felt. At its best, in its fact-finding rôle, this school performs an indispensable service. At its worst, in its mechanistic tendencies, in its contempt for the intangibles, in its exaltation of experimental formulæ as the ultimate solution for every economic problem, it has less claim upon our respect. The history of reparations suggests that we shall not make rapid progress in the solution of international problems if we treat too seriously the pretensions of economic science to omniscience.

When our farmers, as well as our manufacturers and merchants, come to see our foreign problems more distinctly as matters of close concern to themselves, we may expect foreign affairs to occupy their proper place in our national thought. Even now we are learning that in our great national strength there are elements of dependence upon others. It is becoming clearer to us that power confers no lasting immunity from the obligations of world citizenship. A new significance of international coöperation is slowly becoming apparent. Political idealists have long dreamed of such coöperation, and their dreams have been derided by "practical" men. To-day, the economic

realist is bringing it into being. The achievements in the international field of such truly practical men as Dawes, Young, and Robinson are the evidence. These men not only believed that international understanding has a spiritual value; they knew it to be an economic necessity.

THE END

APPENDIX

TABLE I

NATIONAL DEBT INCURRED BY GERMANY

(See text, pp. 232–237.)

	DEBT INCURRED (billions of marks)		(a) DOLLAR VALUE OF MARK	DOLLAR VALUE OF DEBT AS INCURRED (billions of dollars)	
INTERNAL PRE-WAR DEBT (amount at 1914)		5.0	(gold par) .238		
INTERNAL WAR DEBT:					
1914	8.0		.235	1.9	
1915	21.2		.206	4.4	
1916	28.3		.183	5.2	
1917	34.5		.141	4.8	
1918	47.3		.159	7.5	
Total		139.3	.171		23.8
INTERNAL POST-WAR DEBT:					
1919	32.2		.032	1.0	
1920	67.5		.017	1.2	
1921	93.5		.012	1.1	
1922 (first 3 months)	24.5		.0045	.1	
1922 (last 9 months)	(b)		.0016	.3	
1923 (first 9 months)	(b)			.3	
Total		217.7			4.0

Total Internal Debt (extinguished by inflation and demonetization of old mark)		(c) 362.0			29.0
Gold Loans of Late 1923	.45				
Other New Debt Incurred Since Stabilization to March 31, 1927	3.95				
Total new debt		(d) 4.40			
Less foreign loan of 1924, repayable out of reparation annuities		.90			
Net new debt		3.50	(gold par) .238		
Reparation Debt (estimated value at 4% of annuities under the Dawes Plan—see text, page 220)		37.80	(gold par) .238		9.0
Total					38.8

Total debt incurred, 38.8 billion dollars.
1920 population, 60,800,000.
Per-capita debt incurred, $638.
Equivalent to 34.9 months' pre-war income (income estimate by Helfferich) (see general note appended to Table III).

(a) Yearly average New York cable rates, per *Harvard Review of Economic Statistics*, Supplement, December, 1926. Rates for 1917 and 1918 are calculated through the Amsterdam dollar and mark rates on each July 4—see London *Economist*, July 6, 1918. Rate of .0045 for 1922 is the average for the first three months (average for the year .0023).

(b) No attempt is made to deal with mark debt incurred during the period of extreme inflation in 1923 as the data are meaningless. This condition affects also the last nine months in 1922, since the debt figures are not separately shown in *The German Statistical Year Book* (1923, p. 357), but are merged with those for the three months ended March 31, 1923. In the above table estimated gold figures are inserted for the eighteen months in question on the same basis as the debt incurred during the first three months of 1922.

(c) Total debt incurred and extinguished by inflation, 362 billion marks to March 31, 1922, see *French Public Finance*, Harvey E. Fisk, Bankers Trust Co., New York, 1922, p. 138. Mr. Fisk's yearly totals, which cover fiscal years ending each March 31st, have been adjusted above to calendar years on a proportionate basis.

(d) Post-inflation debt, total 4.4 billion marks, from *European Economic and Political Survey*, American Library in Paris, 10 rue de l'Élysée, June 15, 1927, p. 659.

TABLE II

NATIONAL DEBT INCURRED BY FRANCE

(See text, pp. 232–237.)

	Debt incurred (billions of francs)		(a) Dollar value of franc	Dollar value of debt as incurred (billions of dollars)	
Internal Pre-War Debt (amount at 1914)		34.0	(gold par) .193		6.6
Internal War Debt:					
1914	5.0		.195	1.0	
1915	17.0		.148	2.5	
1916	19.0		.132	2.5	
1917	20.0		.126	2.5	
1918	49.0		.116	5.7	
Total		110.0	.129		14.2
Internal Post-War Debt (including reconstruction debt, see Table V):					
1919	36.0		.110	4.0	
1920	35.0		.070	2.4	
1921	17.0		.075	1.3	
1922	21.0		.082	1.7	
Total to end of 1922 (b)	109.0		.086	9.4	
1923	24.5		.061	1.5	
1924	6.8		.052	.3	
1925–6 (to August 31, 1926)	2.2		.042	.1	
Total		142.5	.079	-	11.3

TOTAL INTERNAL DEBT INCURRED	(c) 286.5	.112			32.1
RECONSTRUCTION DEBT STILL TO BE INCURRED (estimate by Louis Loucheur, see Table V)	12.5	.040			.5
TOTAL INTERNAL DEBT INCURRED AND TO BE INCURRED	299.0	.109			32.6
FOREIGN MARKET BORROWINGS (high point, December 31, 1918)					1.2
DEBT TO UNITED STATES GOVERNMENT:					
Face value			3.3		
Interest in arrears, to be funded (as of June 15, 1925)			.7		
Total nominal amount			4.0		
Less amount cancelable through reduction of interest rates under unratified Mellon-Bérenger Agreement of April 29, 1926			1.9		
Net debt (value of Mellon-Bérenger annuities, calculated at 4%)				2.1	
DEBT TO BRITISH GOVERNMENT (face value £653,000,000)			3.2		
Less amount cancelable under unratified Churchill-Caillaux Agreement of July 16, 1926			1.8		
Net debt (value at 4% of Churchill-Caillaux annuities)				1.4	3.5
GROSS DEBT INCURRED					37.3
Less interally debts receivable (excluding Russian debt) 6.6 billion francs at gold par .193			(d)	1.2	
Less reparation debt receivable (53% of 9 billion dollars, see text, page 220)				4.8	6.0
TOTAL					(b) 31.3

Total debt incurred, 31.3 billion dollars.
1920 population, 38,500,000.
Per-capita debt incurred, $813.
Equivalent to 35.2 months' income (income estimate by Pupin). (See general note appended to Table III.)

(a) For 1914 and from 1920 on, yearly average New York cable rates are used. For the years 1915 to 1919, the exchange value of the franc was higher than its real value, owing, in at least a portion of this period, to artificial support of the franc exchange (1915 rate, .1797; 1916, .1697; 1917, .1731; 1918, .1780; 1919, .1368). The value used in the table has, therefore, been computed by dividing the par value of the franc by the French wholesale price index number for the year, which gives 1913 dollar equivalent, and the latter has been multiplied by the United States wholesale index number to give current dollar equivalent, thus: $\frac{\text{U. S. Index}}{\text{French Index}} \times .193$. This method may be tested for years in which artificial control of the exchange was not exercised and will be found to give a result approximately equivalent to the exchange rates. For example: In 1924, the French index number was 488; in other words, the franc was worth only about a fifth of pre-war. It could have bought only about a fifth of 19.3 cents, or 3.95 cents. But those cents had themselves depreciated in value against commodities. In 1924, they could buy only about $\frac{2}{3}$ of what they bought in 1913, as indicated by the American 1924 index number of 139. Multiplying 3.95 by 1.39, we find 5.49 cents to represent the true 1924 parity of the franc. The average exchange rate for that year was 5.23 cents. The absence of index numbers for Germany during the years 1915–1918 makes it impossible to test the real value of the mark during those years. The index numbers used in this table are taken from the *Harvard Review of Economic Statistics*, as follows: Bradstreet's United States index, 1915, 107; 1916, 128; 1917, 170; 1918, 203; 1919, 203; and *Statistique Général* French index, 1915, 140; 1916, 188; 1917, 262; 1918, 339; 1919, 356. See further on this subject Professor Gustav Cassel (*Enc. Britt.* New Vols., I, 1086) who demonstrates that "the rate of exchange is determined by the quotient of the purchasing powers of the currencies."

(b) While a comparison of this table with Table I (Germany) shows the reasonable basis of the settlement effected by the Dawes Plan, as the facts now appear, it does not reconstruct the situation as it stood at the end of 1922, when the French declined the British proposal to cut the German reparation debt to 11.9 billion dollars (French share, 6.2 billions). At August 31, 1922, the French Treasury stated that it had spent 55 billion francs for reconstruction, and that it estimated that the remaining costs would be another 55 billion francs (a total of 110 billion francs as compared with 100 billion, the probable final figure now—see Table V). The average dollar value of the debt incurred to 1922 was

.086 per franc. There was no general expectation among the French at that time of a demonetization of the franc to a low level, and the completion of the work as then estimated would have resulted, on the basis of the exchange rates ruling in 1922 (.082), in a total cost of 9.2 billion dollars. The total cost, as it now appears (see Table V), is 7.4 billion dollars The obligations faced by the French in 1922, therefore, appeared to be greater than those shown in the above table, by 1.8 billion dollars for reparations, as well as by 1.9 billion dollars for the American debt, since the concession of that amount by the United States was not made until 1926. (The concession by England on the French debt, however, had been offered in connection with the British reparation proposal of 1922, in an amount of about 2 billion dollars.) In addition, there was serious doubt, in the conditions then prevailing, whether the interally debts receivable, shown above at 1.2 billion dollars, had any value at all. Taking these factors into consideration, the position of France on debt accounts appeared in 1922 to be nearly 5 billion dollars more unfavourable than as shown above.

(c) Year by year borrowings to 1921 from Harvey E. Fisk, *op. cit.* (Table I), p. 28; total to end of 1924, 284.3 billion francs, per *The French Debt Problem*, Moulton & Lewis, The Macmillan Company, New York, 1925, p. 434; total at August 31, 1926, per *European Economic and Political Survey*, January 15, 1927, p. 185.

(d) Interally debts owing to France at April 30, 1926, 6.6 billion gold francs (excluding 7.1 billion gold francs loaned to the Czarist and other Russian governments) per *European Economic and Political Survey*, January 15, 1927, p. 186. It is not entirely clear whether these obligations are in gold francs. Ambassador Bérenger, in his memorandum of March, 1926, to the United States Debt Funding Commission, states them in dollars at current rate of the franc. He says that "the exact amount of these credits cannot be finally determined until a settlement has been reached with most of the countries concerned." It seems probable that the real value of these debts is considerably less than the figure of 1.2 billion dollars at which they appear in the above table.

TABLE III

NATIONAL DEBT INCURRED BY GREAT BRITAIN

(See text, pp. 232–237.)

	DEBT INCURRED (millions of pounds)	(a) DOLLAR VALUE OF DEBT AT GOLD PAR, $4.8665 TO THE POUND (billions of dollars)			
INTERNAL PRE-WAR DEBT (amount at 1914)	706			3.4	
WAR DEBT TO MARCH 31, 1919 (net increase over pre-war debt, excluding American debt)	(b) 5930			28.9	
POST-WAR DEBT (net increase in debt to high point at March 31, 1923)	231			1.1	
Total	(c) 6867				33.4
EXTERNAL DEBT:					
Debt payable to United States Government:					
Face value of loans	(c) 837		4.1		
Unpaid interest funded as of December 15, 1922	(c) 108		.5		
Nominal amount funded			4.6		
Deduct amount cancelled through reduction of interest rates			.6		
Value of annuities under funding agreement, at 4%				4.0	
Less debts receivable:					
Reparation debt owing by Germany (22.5% of 9 billion dollars, see text, page 220)			2.0		
Debt owing by Italy (£611,000,000, face value)		3.0			
Deduct amount cancelled by reduction of interest rates		2.5			
Value of annuities, at 4%, per funding agreement of January 27, 1926		.5			
Debt owing by France (value at 4% of unratified settlement, see Table II)		1.4			

Other interally debts owing to Great Britain (balancing figure) (d)...		.1	2.0		
Total intergovernmental debts receivable....................				4.0	
NET EXTERNAL DEBT....................................					0.0
TOTAL....................................					33.4

Total debt incurred, 33.4 billion dollars.
1920 population, 47,000,000.
Per-capita debt incurred, $711.
Equivalent to 23.4 months' pre-war income (Stamp's income estimate) or 19.5 months' post-war income, (income estimate by the London *Economist*, March 14, 1925). (See general note following this table.)

(a) Great Britain returned to a gold basis in 1925, and the British debt is, therefore, stated in dollars at gold par.

(b) Debt figures to March 31, 1919, per Harvey E. Fisk, *French Public Finance*, p. 139.

(c) Total of these three amounts is 7.812 billion pounds, representing the high point of the British debt at March 31, 1923. (See *Economist*, June 18, 1927, p. 1304.)

(d) Interally and other intergovernmental debts owing to Great Britain, excluding France and Italy, at the end of 1924, at face value (sterling at par) were: Russia, 3.4 billion dollars; British dominions, 640 million dollars; others, 644 million dollars. (See *The Inter-Ally Debts and the United States*, National Industrial Conference Board, 1925, p. 26.) Great Britain has given an undertaking to Italy, and has embodied a similar provision in the proposed debt-funding agreement with France, that any excess received by her from interally debts and reparations over the amounts required from year to year to meet her American debt payments will be credited pro rata to her Allies on interally debt account. If, therefore, her settlements with her other debtors (excluding Russia) should amount to, say, 500 million dollars, her total debts receivable, with those owing by Germany, France, and Italy, would come to 4.4 billions. On the basis of the above table, this excess of 400 millions would be prorated as a credit to all the Allies, bringing the French debt down to about 1.2, Italy to .4, and other Allies to .4, or a total of 2 billion dollars.

GENERAL NOTE ON INCOME ESTIMATES OF GERMANY, FRANCE, AND GREAT BRITAIN

For a comparison of national debt burdens, it is essential that the per-capita debt figures be related to national income. Post-war income estimates of any reliability for Germany and France, where the currencies have fluctuated widely, are unobtainable. The per-capita debt figures have therefore been carried back to a pre-war basis for comparison with pre-war income estimates. This has been done by dividing by 1.50, which is the approximate wholesale price index in the United States in 1927 (and approximate average since 1914); that is to say, pre-war prices were approximately ⅔ of prices now. In price index numbering, the base, 1.00 (usually written without the decimal), represents 1913 prices. The post-war increase of 50 per cent. in prices is frequently referred to as a depreciation of 50% in the value of gold.

The national income figures used are as follows: Germany, 1914, £30 or $146 per capita, estimate by Sir Josiah Stamp based on the work of Dr. Karl Helfferich of the Deutsche Bank; France, pre-war, £38 or $185 per capita, estimate by Stamp, based on the work of Réne Pupin; Great Britain, pre-war, £50, or $243 per capita, estimate by Stamp, based on the work of Bowley and Stamp. (*Journal of the Royal Statistical Society*, London, July, 1919.) An estimate of British post-war income by the London *Economist* (March 14, 1925) has also been used, viz., £90, or $438.

TABLE IV

NATIONAL DEBTS (1927) OF GERMANY, FRANCE, AND GREAT BRITAIN AT CURRENT RATES OF EXCHANGE

	GERMANY AT MARCH 31, 1927			FRANCE AT AUGUST 31, 1926			GREAT BRITAIN AT MARCH 31, 1927	
	MARKS (billions)	RATE	DOLLARS (billions)	FRANCS (billions)	RATE	DOLLARS (billions)	POUNDS (billions)	DOLLARS (billions at par, $4.8665)
HIGH POINT OF INTERNAL DEBT INCURRED (see Tables I, II, and III)..	(a)366.4		30.0	286.5	.112	32.1	6.87	33.4
Less debt retired:								
By inflation and demonetization....	362		29.0					
By inflation....................						20.6		
By taxation....................							.12	.5
ACTUAL INTERNAL DEBT, 1927 (marks, francs, and sterling per respective Treasury statements)............	4.4	(b) .238	1.0	286.5	(c) .04	11.5	6.75	32.9
EXTERNAL DEBT, 1927:								
Germany, reparation debt (estimated value, see text, page 220).........	37.8	.238	9.0					
France:								
Market debt (per Treasury statement).......................				22.5	.04	.9		

Debt to United States, net value (see Table II)				52.5	.04	2.1		
Debt to Great Britain, net value (see Table II)				35.0	.04	1.4		
Great Britain, debt to United States, net value (d)							.80	3.9
Gross debt	42.2	.238	10.0	396.5	.04	15.9	7.55	36.8
DEDUCT:								
Germany, external loan included in reparation debt	.9	.238	.2					
France, reparations and interally debts receivable				150	.04	6.0		
Great Britain, reparations and interally debts receivable							.80	3.9
NET DEBT, AT CURRENT RATES OF EXCHANGE	41.3	.238	9.8	246.5	.04	9.9	6.75	32.9

Germany, 9.8 billion dollars, $161 per capita; equivalent to 8.8 months' estimated pre-war income. (e)
France, 9.9 billion dollars, $257 per capita; equivalent to 11.1 months' estimated pre-war income. (e)
Great Britain, 32.9 billion dollars, $700 per capita; equivalent to 23 months' estimated pre-war income or 19.2 months' estimated post-war income. (e)

General Note. For reasons set forth in the text, pages 232–237, the above comparison of current debts at current exchange rates has not the same true significance to the subject of relative burdens as the comparison based on Tables I, II, and III.

(a) See note (b) Table I.

(b) Present German debt at par.

(c) The rate of exchange used for the franc, namely, .04 (current rate, June, 1927) represents the value at which in June, 1927, it seemed likely that the franc might ultimately be permanently stabilized.

(d) The British debt to the United States stated above at 3.[illegible] billion dollars is carried in all official accounts at its face value, without taking nto consideration the effective reduction of 600 million dollars through reduction of interest rates (see Table III). As funded in 1922, the face value was 4.6 billions; since that date, 100 millions of the principal has been retired by the British, by taxation, leaving a face value of 4.5 billion dollars at the end of 1926.

(e) Income estimates, see general note appended to Table III.

TABLE V

COST OF RECONSTRUCTION TO FRANCE

	FRANCS (billions)		DOLLAR RATE	VALUE IN DOLLARS (billions)
RECONSTRUCTION DEBT INCURRED, 1919–1924:				
For repair of damage to private property.		(a) 59.3		
For repair of damage to railways and public property and for costs of administration		(a) 12.7		
		72.0	(b) .079	5.69
RECONSTRUCTION DEBT INCURRED, 1925 (estimated portion of total debt of 2.2 billion francs incurred 1925–1926, see Table II)		1.5	.048	.06
ESTIMATED COST TO COMPLETE RECONSTRUCTION, 1926 (£100,000,000) (c)		12.5	.040	.50
Total property damage.		(d) 86.0		6.25
DEBT INCURRED TO DECEMBER 31, 1924, FOR PAYMENT OF INTEREST:				
On loans contracted for reconstruction and for pensions	(a) 19.0			
On indemnities.	2.6			
Total.	21.6			
Less estimated amount applicable to pensions (⅓).	(e) 7.2	14.4	(b) .079	1.14
TOTAL EXPENDED AND TO BE EXPENDED.		100.4	.074	(f) 7.39

(a) Émile Mireaux, Director of the Society for Economic Studies and Information, Paris, and Associate Professor at the University of Paris (*Enc. Britt.*, New Vols., II, 103).

(b) Average rate at which the entire French post-war debt 1919–1924 was incurred, see Table II.

(c) Work remaining to be done estimated at £100,000,000 by Louis Loucheur, former French Minister for the Liberated Regions (*Enc. Britt.*, New Vols. (1926) II, 106).

(d) In March, 1926, Ambassador Bérenger estimated that the total approved claims for indemnities for the liberated regions would amount to 83.5 billion francs, of which he stated that 63 billion had been paid out to June 30, 1923. This estimate was arrived at as follows: of the total individual claims submitted, amounting to 123 billion francs, 106 billion had been examined and allowed in the sum of 72 billion, or 68% of the amounts claimed. Applying 68% to 17 billion unexamined claims gives 11.5 billion still to be allowed, or a total estimated cost of 83.5 billion. (p. 49, English text of his memorandum presented to the United States Debt Funding Commission, published by the Reference Service of the American Library in Paris).

(e) Reconstruction and pension costs, recoverable from Germany under the provisions of the Treaty, were financed by loans. The costs to December 31, 1924, as stated by Prof. Mireaux, were 72.0 billion francs for reconstruction, as shown above, and 36.4 billions for "damage to persons," a total of 108.4 billions. This plus 21.6 billion francs interest comes to 130 billion francs all of which is apparently represented by public debt, since Professor Mireaux states that 45% of the French internal debt (amounting in all to 284 billion francs) "comes from the expenditure for the reparation of war damage." He adds that "one sixth of the French budget was devoted in 1926 to the service of this debt."

(f) The original estimate of damage sustained which was submitted in February, 1921, by the French government to the Reparation Commission, was made in gold francs, pre-war value, amounting to 6.7 billion pre-war dollars. With interest at 5% to May 1, 1921, amounting to 800 million dollars, the total came to 7.5 billion dollars. The equivalent to-day would be 11.3 billion dollars. The estimate, which filled a book of 1,100 pages, was based on, among other things, a survey of real property of all the cities and communes of France made for tax purposes in 1910 on the basis of actual sale values. (See note, p. 96 above.)